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YOUTH SMOKING PREVENTION AND STATE REVENUE ENFORCEMENT ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

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YOUTH SMOKING PREVENTION AND STATE REVENUE ENFORCEMENT ACT

THURSDAY, MAY 1, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS, THE INTERNET,
AND INTELLECTUAL PROPERTY,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:04 a.m., in Room 2141, Rayburn House Office Building, Hon. Lamar Smith [Chairman of the Subcommittee] presiding.

Mr. SMITH. The Subcommittee on Courts, the Internet, and Intellectual Property will come to order. We have an interesting hearing this morning. I will recognize myself and the Ranking Member and also Representative Green for our opening statements, and the entire opening statements of all members will be made a part of the record without objection, as well as the entire testimonies of all witnesses today.

Teenagers who make it through adolescence without having smoked are nearly certain not to become regular smokers. Among adults who smoke, most report having their first cigarette before the age of 13. Governments at all levels have worked with those in the public health community to enact policies that discourage individuals from smoking cigarettes.

Two cornerstones of our effort have been, one, strictly enforcing minimum age laws and, two, increasing the collection of excise, sales and use taxes from consumers in an effort to drive the price of smoking up and the demand down.

Due to their limited incomes, underage smokers are especially sensitive to increases in cigarette prices. They are also among the most proficient users of the Internet, and they have a great incentive to seek anonymity for their purchases. Regrettably, a new breed of remote sellers doing business by mail order, the telephone, and the Internet now promise cigarette consumers both discounted prices and anonymity.

With names such as zerotaxcigs.com and zerotaxsmokes.com, and taxfreecigarettes.com, their activities are raising serious questions about the ability of governments at all levels to enforce their public health, youth access, and State tax policies effectively. These remote sellers have made it easier for customers to avoid paying taxes and for teenagers to avoid minimum age laws.

The purpose of our hearing today is to consider H.R. 1839, the "Youth Smoking Prevention and State Revenue Enforcement Act," which was introduced by Representative Mark Green of Wisconsin.

Representative Green's bill authorizes State attorneys general to bring a civil action seeking injunctive relief in an appropriate U.S. district court for violations of the Jenkins Act.

Since enacting the Jenkins Act in 1949, our Federal policy has been to support State and local efforts to tax and regulate the sale of cigarettes in interstate commerce.

The Jenkins Act requires any person selling cigarettes for profit in interstate commerce to report to State tobacco tax administrators the name and address of the persons to whom the cigarettes were shipped and the brands and quantities shipped.

The Act's purpose is to enable State authorities to have an effective mechanism for recovering excise, sales and use taxes from consumers who seek to avoid paying State taxes by purchasing cigarettes from low-tax or no-tax jurisdictions.

One projection is that U.S. Internet tobacco sales will exceed $5 billion in 2005 and that States will lose $1.4 billion in State tax revenues as a result. Representative Green's legislation enables States to enforce compliance with their public health, youth access, and cigarette tax policies, thus both increasing States' revenue and reducing health care risks and costs.

I would like the record to show and reflect that representatives from two online tobacco retailers were asked to testify, and it is no surprise perhaps that they declined to do so, but we do look forward to hearing from the witnesses who are here today.

I will now recognize the Ranking Member, Mr. Meehan of Massachusetts, for his opening statement.

Mr. MEEHAN. Thank you, Mr. Chairman, and I want to thank you for scheduling these hearings. As you know, I have been working on Internet and mail order tobacco sales for 5 years. I certainly appreciate the willingness to address this issue. I also want to thank Congressman Green for offering to work together on this issue. We have had some constructive discussions about H.R. 1839, and I am convinced that he understands the need for an effective solution to the problem of tax avoidance in connection with remote sales of tobacco products.

I would like to be able to support H.R. 1839, but I cannot do so in its current form. I have drafted my own version of the bill, but I have not introduced it because I didn't want to preempt Mr. Green or this hearing. I hope that we will be able to reach an agreement on a strong bipartisan bill.

My basic concern is that H.R. 1839 does not do enough to strengthen the Jenkins Act, which already normally requires cigarette distributors to comply with the tax laws of the States where they send their products. If we don't close the loopholes and strengthen the weaknesses that have made the Jenkins Act completely ineffective, we will not be accomplishing much but simply passing a new version of the law.

Coalition for Tobacco Free Kids will outline some of the specific provisions that need to be addressed to make sure that H.R. 1839 gets the job done, but I will highlight a few areas that I think are particularly important. The first problem is that H.R. 1839 contains no felony provision or increased fines. In a report issued last year the GAO noted that prosecutions under the Jenkins Act are extremely rare because U.S. attorneys have little interest in pros-

ecuting misdemeanors. Retailers who rely on the Internet to generate sales are largely fly-by-night operations. Injunctive relief is meaningless against these sellers because they simply close up shop and then start over under a new name. The idea of giving States the ability to bring civil claims against other out-of-state sellers in Federal court is a step in the right direction, but is unlikely to have much practical effect when defendants have nothing at risk but the tax money that they should have paid in the first place. The credible threat of criminal prosecution, backed up by meaningful penalties, including substantial fines and imprisonment, is essential in order to make this bill work.

The second issue I want to point out is that H.R. 1839 covers only cigarettes. I do not think there is any logical reason to leave a loophole for Internet mail order smokeless tobacco such as chew and snuff.

The third concern or set of concerns I want to raise is that H.R. 1839 includes a number of drafting problems that appear minor and may have unintended consequences. I know that Congressman Green has been working diligently to finish his draft of the bill in time for this hearing, but these issues will also need to be addressed.

For example, I think H.R. 1839 is intended to establish the right of States to sue tobacco sellers and distributors for the failure to obey State tax laws, but it is not entirely clear from the language whether the States would be entitled to hold a seller or distributor responsible for refusing to collect taxes that they are owed by consumers, such as excise tax. If States are forced to sue individual consumers for tax evasion, the bill is simply not going to be effective.

I hope that we can rework some of these areas and provisions in 1839 to make sure that it achieves its intended goals. I am optimistic that together we will be able to produce a strong bipartisan bill that could pass both Houses of Congress and solve the problem.

Thank you, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Meehan. The gentleman from Wisconsin, Mr. Green, is recognized for his opening statement.

Mr. GREEN. Thank you, Mr. Chairman. Thanks first for the opportunity to have the Subcommittee consider this legislation. This legislation addresses a growing problem in this country, the largely unregulated sale of cigarettes by mail, telephone, and the Internet. As you have already heard, these remote sales usually occur across State lines and result in cigarettes being delivered directly to someone's door while evading State laws, sales to children and sales taxes.

I want to acknowledge my colleague and friend, Congressman Meehan. He has been a leader on this subject and I admire his work very much and I do want to work with him. I am hopeful that we can produce soon a product that will be effective. My bottom line is to get something done that will work.

This legislation will give State attorneys general the tools they need to enforce their laws against habitual evasion by remote sellers. My bill will allow attorneys general to bring suit in Federal court against all remote sellers.

This is a problem that is getting out of hand. Anyone today can get on the Internet, run a quick search for tax free cigarettes or a variation of that phrase and find literally hundreds of Web sites offering cigarettes for sale. In fact, there is a special Internet search engine set up just for Internet tobacco sites. With nothing more than a credit or debit card our children can access these sites, buy cigarettes and have their cigarettes delivered right to their door without an ID. This will only get worse because, as we all know, children are among the most frequent and proficient users of the Internet.

States are largely powerless to stop those rampant violations of the minimum age laws because the businesses selling to their children are outside of their borders or otherwise outside the reach of State law. The New York Department of Consumer Affairs has managed to get traditional retail sellers of cigarettes to an 85 percent compliance rate with minimum age laws. But the department has found its efforts literally gutted by the proliferation of remote sellers that it cannot regulate.

At the same time, as has been mentioned, States are losing taxes on these sales. One of our witnesses today, economist Patrick Fleenor, will estimate that State governments will lose over $552 million in sales and excise tax revenue this fiscal year and this figure will grow to 1.2 billion by fiscal year 2005. My home State of Wisconsin is expected to lose 9 million this year and over $26 million in 2005 at a time when my State, like so many others, is suffering and is challenged in trying to balance its books.

The Jenkins Act, which first became law in 1949, requires remote sellers of cigarettes to report their sales to the States so that States can collect the taxes. This is a great idea. The problem is that remote sellers don't comply with the law and no one has been able successfully to enforce it.

The United States General Accounting Office recently reviewed 147 Internet sites that sell cigarettes and not a single one of those sites complied with the Jenkins Act. In fact, many of these sites openly promote their law breaking by offering tax free cigarettes and say they, quote, don't report sales. The Web addresses, as, Mr. Chairman, have you pointed out, clearly reveal the sellers' intentions. These sites include notaxcigarettes.com and zerotaxcigarettes among many others.

In light of these open violations of the law, the GAO looked at State efforts to enforce the Jenkins Act and they didn't find very much. Why? Well, the GAO heard from nine States on this and every one of them said that they did not have the necessary legal authority. The GAO also looked at Federal enforcement efforts and found that, quote, no Internet cigarette vendors have been penalized for violating the act nor had any penalties been sought for violators. These lost funds again loom even larger now that so many States are laboring to find ways to cut their budgets to make up for revenue shortfalls.

Obviously the public health consequences are also very important. Many States increase cigarette costs through State excise taxes for the stated purpose of deterring smoking. We lose those benefits of these taxes when we allow large volumes of sales to evade those tax schemes.

Remote sales of cigarettes are also hurting local economies. Local small businesses cannot compete with the legal tax free sales by remote businesses.

Mr. Chairman, we should not allow the situation to continue. The rampant evasion of State law is precisely the type of issue that Congress should address, and the best way for to us do this is to give States the tools they need to effectively enforce their laws against all remote sellers.

This legislation will do this and do it the right way. It will keep the authority to enforce State and local laws in the hands of State law enforcement. It avoids creating an unfunded mandate, avoids creating a new Federal bureaucracy and it avoids interfering with or outlawing legitimate commerce.

Mr. Chairman, I hope you will agree with me that this is a problem and these illegal cigarette sales to children is an issue that we must take up as a Committee. Again, I do want to work with some who are currently opposing this legislation. I think there are some things that we can do. I think we all agree that the bottom line is to pass something that will work and work soon.

Mr. Chairman, thank you again for holding this hearing and I appreciate the willingness of our witnesses to come and testify today.

Mr. SMITH. Let me thank other members who are here for their attendance as well. Mr. Jenkins of Tennessee, Mr. Keller of Florida, Mr. Forbes of Virginia and also Mr. Boucher of Virginia as well. This Subcommittee consistently has interested Members and good attendance. I am very pleased that that continues.

Let me proceed now to introduce our witnesses. And our first witness is Paul Jones, the Director of Homeland Security and Justice at the U.S. General Accounting Office. Mr. Jones is responsible for the management of programs and issues in the U.S. Department of Justice and the Department of Homeland Security. Mr. Jones graduated with honors from Elizabeth City State University with a B.S. in mathematics and earned a Master's Degree in public administration from George Washington University.

The next witness is Hank Armour, President and Chief Executive Officer of two corporations, West Star and Epoch, with convenience stores in the Northwest. Dr. Armour founded West Star in 1982 and Epoch in 1988. Mr. Armour earned a B.A. and Ph.D. in economics and an MBA from Stanford. He also holds a degree from the London School of Economics.

Our next witness is Matthew Myers, president and CEO of the Campaign for Tobacco Free Kids, a non-profit organization established to focus attention on reducing tobacco use among minors. Mr. Myers formerly represented the Coalition on Smoking and Health, which was comprised of the American Cancer Society, the American Lung Association, and American Heart Association. He holds a B.A. from Tufts and a J.D. from Michigan.

Our last witness is Patrick Fleenor, a Washington-based economic consultant who specializes in taxation. Prior to opening his own practice he was a senior economist with the Joint Economic Committee. He has also served as Chief Economist for the Tax Foundation, one of the nation's oldest think tanks. Mr. Fleenor holds a B.A. from Albion College and an M.A. in economics from

George Mason, and an M.A. in political science from American University.

Welcome to you all. As I mentioned to you a while ago, all your complete statements will be made a part of the record, and I will remind you that we would like for you to hold your opening statements to 5 minutes so that we will have plenty of time for questions.

I should also mention to members that are here that we are expecting a vote on the House floor on the rule somewhere around 11 to 11:15 and will hope to be finished with the hearing by that time.

Also to the witnesses, I don't know whether to apologize or just explain, but what is new to you is new to us as well. This is the first time we have seen that screen in the front. Mr. Myers, I am sorry that kind of blocks us. I can't see your name tag there but we will make do. This is also new up here. I want you to know this screen is off but I could be watching a basketball game and I am not. And also new is the corner arrangement over there. All good reasons for all these new arrangements, but nevertheless still may take some getting used to.

Thank you all for being here.

Mr. Jones, we will start with your testimony.

STATEMENT OF PAUL L. JONES, DIRECTOR, HOMELAND SECURITY AND JUSTICE, GENERAL ACCOUNTING OFFICE

Mr. JONES. Thank you, Mr. Chairman. Mr. Chairman, Members of the Subcommittee, I am pleased to be here today to discuss our review—I forgot to press the button. New technology. I am pleased to be here today to discuss our review of the state of compliance by Internet cigarette vendors with the Jenkins Act.

The Internet offers consumers the option and convenience of buying cigarettes from vendors in low tax States without having to physically be there. The Jenkins Act requires any person who sells and ships cigarettes across a State line to a buyer other than a distributor to report the sale to the buyer's State tax tobacco administrator. The act establishes misdemeanor penalties for violations. Compliance with this Federal law by cigarette sellers enables States to collect excise taxes.

My prepared statement discusses the results of our review of Federal efforts to enforce compliance with the Jenkins Act. I appreciate having my statement included for the record.

The results of our review were requested by Congressman Meehan and Congressman Conyers. The results of that review was reported in August of 2002.

In my oral statement I would briefly like to make three points. First, we determine that most Internet vendors do not comply with the Jenkins Act or notify their customers of their responsibilities under the act. We identified 147 Web site addresses for Internet cigarette vendors based in the United States. None of these Web sites displayed information suggesting that they comply with the act. Conversely, 78 percent of these Web sites indicated that the vendors do not comply with the act. They posted such statements as we do not comply with the Jenkins Act, we do not report sales to State tax authority, and we keep customer information private.

Twenty-two percent provided no indication of whether they complied with the act.

Internet vendors cited the Internet Tax Freedom Act and privacy laws among reasons for not reporting cigarette sales to State authorities. A number of native Americans claim exemption from the act based on sovereign nation status. Our review indicated neither the Internet Tax Freedom Act or privacy laws exempt cigarette vendors from Jenkins Act compliance. Additionally, nothing in the Jenkins Act or its legislative history implies that Native American cigarette sales are exempt.

Second, State and Federal officials are concerned that as Internet sales continue to grow, particularly as State cigarette taxes increase, so will the amount of lost State tax revenue due to noncompliance. One research firm estimated that Internet tobacco sales in the United States will exceed $5 billion in 2005 and that States will lose about $1.4 billion in tax revenue from these sales. California recently estimated that its tax loss revenue due to noncompliance with the Jenkins Act is approximately $22 million annually.

And third, amid these growing concerns the Federal Government enforcement of the Jenkins Act has been limited. The Attorney General of the United States is responsible for supervising the enforcement of Federal laws, including the Jenkins Act. However, the Justice Department and the FBI were unable to identified any investigations of Internet cigarette vendors or other actions to enforce the act. The Bureau of Alcohol, Tobacco and Firearms, which enforces Fed excise tax and criminal laws and regulation related to tobacco products, has ancillary authority to enforce the Jenkins Act. ATF officials identified only three investigations since 1997 of Internet vendors for cigarette smuggling and violating the Jenkins Act.

States have taken action to promote Jenkins Act compliance but results have been limited. We concluded that States are hampered in their attempts to promote Jenkins Act compliance because they lack authority to enforce the act.

Congressman Green's bill, H.R. 1839, gives States authority to bring civil action against Jenkins Act violators. This could lead to greater involvement of States in the enforcement of the Jenkins Act. Hence, this could enhance States' effort to collect excise taxes.

To improve the Federal Government's effort in enforcing the Jenkins Act and to promote compliance with the act by Internet vendors, we suggest in our report that Congress consider providing ATF with primary jurisdiction to investigate violations of the act. Since our report was issued, ATF was transferred to the Department of Justice. Now it may be possible for the Attorney General to administratively transfer Jenkins Act enforcement authority from the FBI to ATF without involving the Congress. We believe that this possibility deserves further investigation on the part of the Department of Justice.

This concludes my oral statement. I would be happy to respond to questions from the Committee.

[The prepared statement of Mr. Jones follows:]

PREPARED STATEMENT OF PAUL L. JONES

I am pleased to be here today to discuss our work on the extent of compliance by Internet cigarette vendors with the Jenkins Act.[1] The Jenkins Act 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 tax administrator. The act establishes misdemeanor penalties for violating the act. Compliance with this federal law by cigarette sellers enables states to collect cigarette excise taxes from consumers.

However, some state and federal officials are concerned that as Internet cigarette sales continue to grow, particularly as states' cigarette taxes increase, so will the amount of lost state tax revenue due to noncompliance with the Jenkins Act. One research firm estimated that Internet tobacco sales in the United States will exceed $5 billion in 2005 and that the states will lose about $1.4 billion in tax revenue from these sales.[2]

My testimony today is based on the results of work that we completed in August of 2002—namely, our report entitled Internet Cigarette Sales: Giving ATF Investigative Authority May Improve Reporting and Enforcement (GAO–02–743). Overall, we found that the federal government has had limited involvement with the Jenkins Act concerning Internet cigarette sales. We also noted that states have taken action to promote Jenkins Act compliance by Internet cigarette vendors, but results were limited.

We determined that most Internet cigarette vendors do not comply with the Jenkins Act or notify their customers of their responsibilities under the act. Vendors cited the Internet Tax Freedom Act, privacy laws, and other reasons for noncompliance. A number of Native Americans cited sovereign nation status. GAO's review indicated that these claims are not valid and vendors are not exempt from the Jenkins Act.

We concluded that states are hampered in attempting to promote Jenkins Act compliance because they lack authority to enforce the act. We suggested that to improve the federal government's efforts in enforcing the Jenkins Act and promoting compliance with the act by Internet cigarette vendors, which may lead to increased state tax revenues from cigarette sales, the Bureau of Alcohol, Tobacco and Firearms (ATF), instead of the Federal Bureau of Investigation (FBI), should be provided with primary jurisdiction to investigate violations of the act.[3] We noted that transferring primary investigative jurisdiction was particularly appropriate because of the FBI's new challenges and priorities related to the threat of terrorism and the FBI's increased counterterrorism efforts.

To perform our work, we obtained information from the Department of Justice (DOJ) and ATF headquarters regarding federal Jenkins Act enforcement actions with respect to Internet cigarette sales. We interviewed officials and obtained documentation from nine selected states[4] regarding states' efforts to promote Jenkins Act compliance by Internet cigarette vendors and estimates of the impact of noncompliance on tax revenues. In addition, we reviewed 147 Internet cigarette vendor Web sites, and we interviewed representatives of five Internet vendors.

BACKGROUND

Each state, and the District of Columbia, imposes an excise tax on the sale of cigarettes, which vary from state to state. As of January 1, 2003, the state excise tax rates for a pack of 20 cigarettes ranged from 2.5 cents in Virginia to $1.51 in Massachusetts (see fig.1). The liability for these taxes generally arises once the cigarettes enter the jurisdiction of the state.

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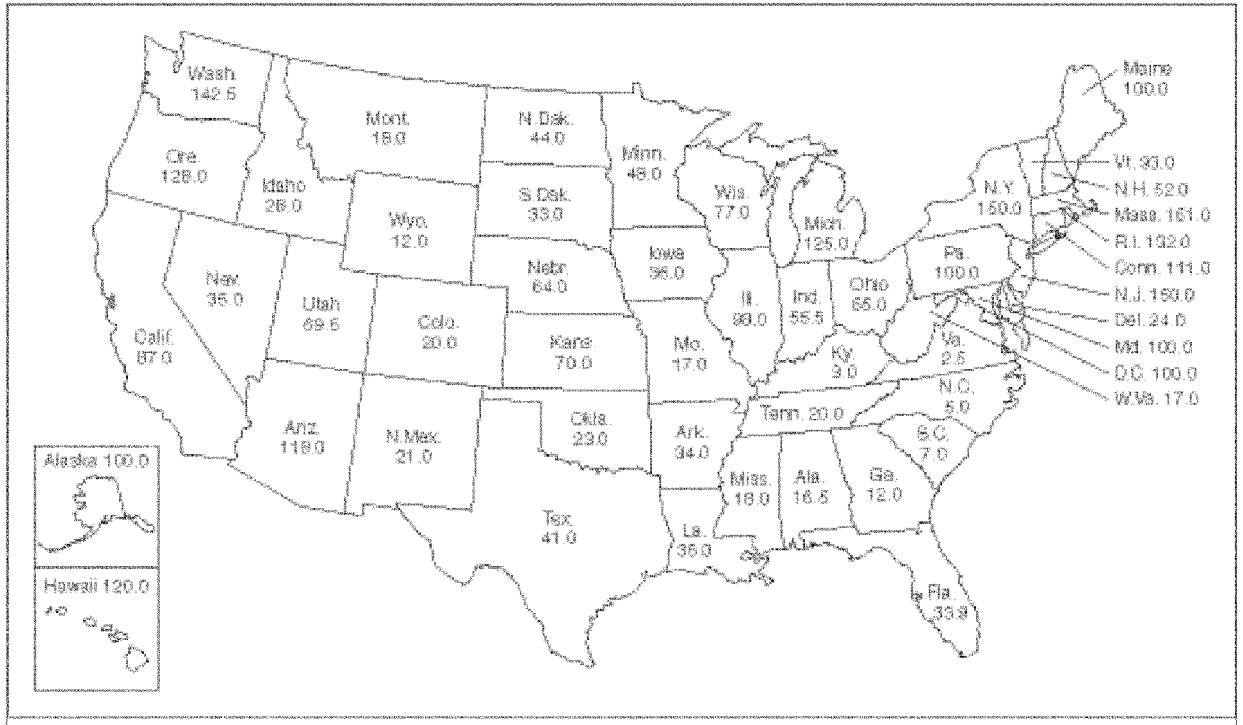
[1] 5 U.S.C. § 375–378.

[2] *Online Tobacco Sales Grow, States Lose,* Forrester Research, Inc. (Apr. 27, 2001). We were unable to assess the reliability of the estimates because the methodology used in developing it, including key assumptions and data, is proprietary.

[3] Since our report was issued, ATF was transferred from the Department of the Treasury to the Department of Justice and is now known as the Bureau of Alcohol, Tobacco, Firearms and Explosives.

[4] We contacted tobacco tax officials in 11 states. Officials in 9 states provided us with information, and officials in 2 states did not provide the information we requested in time for it to be included in our report. We selected the 10 states with the highest cigarette excise tax rates on January 1, 2002, based on the presumption that these states would be among those most interested in promoting Jenkins Act compliance to collect cigarette taxes. Also, we selected one additional state that appeared to have taken action to promote Jenkins Act compliance by Internet cigarette vendors.

Figure 1: State Cigarette Excise Tax Rates, in Cents, Per Pack of 20 Cigarettes, as of January 1, 2003



Sources: Developed by GAO based on Federation of Tax Administrators' data, CorelDraw (map).

Many states have increased their cigarette excise taxes in recent years with the intention of increasing tax revenue and discouraging people from smoking. As a result, many smokers are seeking less costly alternatives for purchasing cigarettes, including buying cigarettes while traveling to a neighboring state with a lower cigarette excise tax. The Internet is an alternative that offers consumers the option and convenience of buying cigarettes from vendors in low-tax states without having to physically travel there.

Consumers who use the Internet to buy cigarettes from vendors in other states are liable for their own state's cigarette excise tax and, in some cases, sales and/or use taxes. States can learn of such purchases and the taxes due when vendors comply with the Jenkins Act. Under the act, cigarette vendors who sell and ship cigarettes into another state to anyone other than a licensed distributor must report (1) the name and address of the person(s) to whom cigarette shipments were made, (2) the brands of cigarettes shipped, and (3) the quantities of cigarettes shipped. Reports must be filed with a state's tobacco tax administrator no later than the 10th day of each calendar month covering each and every cigarette shipment made to the state during the previous calendar month. The sellers must also file a statement with the state's tobacco tax administrator listing the seller's name, trade name (if any), and address of all business locations. Failure to comply with the Jenkins Act's reporting requirements is a misdemeanor offense, and violators are to be fined not more than $1,000, or imprisoned not more than 6 months, or both. Although the Jenkins Act, enacted in 1949, clearly predates and did not anticipate cigarette sales on the Internet, vendors' compliance with the act could result in states collecting taxes due on such sales. According to DOJ, the Jenkins Act itself does not forbid Internet sales nor does it impose any taxes.

LIMITED FEDERAL INVOLVEMENT WITH THE JENKINS ACT AND INTERNET CIGARETTE SALES

The federal government has had limited involvement with the Jenkins Act concerning Internet cigarette sales. We identified three federal investigations involving such potential violations, and none of these had resulted in prosecution (one investigation was still ongoing at the time of our work). No Internet cigarette vendors had been penalized for violating the act, nor had any penalties been sought for violators.

FBI Has Primary Investigative Jurisdiction

The Attorney General of the United States is responsible for supervising the enforcement of federal criminal laws, including the investigation and prosecution of Jenkins Act violations.[5] The FBI has primary jurisdiction to investigate suspected violations of the Jenkins Act. However, DOJ and FBI officials were unable to identify any investigations of Internet cigarette vendors or other actions taken to enforce the act's provisions regarding Internet cigarette sales. According to DOJ, the FBI could not provide information on actions to investigate Jenkins Act violations, either by itself or in connection with other charges, because the FBI does not have a section or office with responsibility for investigating Jenkins Act violations and does not track such investigations. Also, DOJ said it does not maintain statistical information on resources used to investigate and prosecute Jenkins Act offenses.

In describing factors affecting the level and extent of FBI and DOJ enforcement actions with respect to the Jenkins Act and Internet cigarette sales, DOJ noted that the act creates misdemeanor penalties for failures to report information to state authorities, and appropriate referrals for suspected violations must be considered with reference to existing enforcement priorities. Since September 11, 2001, it is understood that the FBI's priorities have changed, as unprecedented levels of FBI resources have been devoted to counterterrorism and intelligence initiatives.

ATF Has Ancillary Enforcement Authority

ATF, which enforces federal excise tax and criminal laws and regulations related to tobacco products, has ancillary authority to enforce the Jenkins Act.[6] ATF special agents investigate trafficking of contraband tobacco products in violation of federal law and sections of the Internal Revenue Code. For example, ATF enforces the Con-

[5] 28 U.S.C. § 533 provides that the Attorney General of the United States may appoint officials "to detect and prosecute crimes against the United States . . ." except where investigative jurisdiction has otherwise been assigned by law.

[6] With ancillary authority to enforce the Jenkins Act, if ATF investigates a possible Contraband Cigarette Trafficking Act violation (i.e., cigarette smuggling), for which it has primary jurisdiction, and determines there is a possible Jenkins Act violation, then ATF may also investigate the Jenkins Act violation and refer it to DOJ for prosecution or injunctive relief.

traband Cigarette Trafficking Act (CCTA), which makes it unlawful for any person to ship, transport, receive, possess, sell, distribute, or purchase more than 60,000 cigarettes that bear no evidence of state cigarette tax payment in the state in which the cigarettes are found, if such state requires a stamp or other indicia to be placed on cigarette packages to demonstrate payment of taxes (18 U.S.C. 2342).[7] ATF is also responsible for the collection of federal excise taxes on tobacco products and the qualification of applicants for permits to manufacture tobacco products, operate export warehouses, or import tobacco products. ATF inspections verify an applicant's qualification information, check the security of the premise, and ensure tax compliance.

To enforce the CCTA, ATF investigates cigarette smuggling across state borders to evade state cigarette taxes, a felony offense. Internet cigarette vendors that violate the CCTA, either directly or by aiding and abetting others, can also be charged with violating the Jenkins Act if they failed to comply with the act's reporting requirements. ATF can refer Jenkins Act matters uncovered while investigating CCTA violations to DOJ or the appropriate U.S. Attorney's Office for charges to be filed. ATF officials identified three investigations since 1997 of Internet vendors for cigarette smuggling in violation of the CCTA and violating the Jenkins Act.

- In 1997, a special agent in ATF's Anchorage, Alaska, field office noticed an advertisement by a Native American tribe in Washington that sold cigarettes on the Internet. ATF determined from the Alaska Department of Revenue that the vendor was not reporting cigarette sales as required by the Jenkins Act, and its investigation with another ATF office showed that the vendor was shipping cigarettes into Alaska. After ATF discussed potential cigarette smuggling and Jenkins Act violations with the U.S. Attorney's Office for the District of Alaska, it was determined there was no violation of the CCTA.[8] The U.S. Attorney's Office did not want to pursue only a Jenkins Act violation, a misdemeanor offense, and asked ATF to determine whether there was evidence that other felony offenses had been committed. Subsequently, ATF formed a temporary task force with Postal Service inspectors and state of Alaska revenue agents, which demonstrated to the satisfaction of the U.S. Attorney's Office that the Internet cigarette vendor had committed mail fraud. The U.S. Attorney's Office agreed to prosecute the case and sought a grand jury indictment for mail fraud, but not for violating the Jenkins Act. The grand jury denied the indictment. In a letter dated September 1998, the U.S. Attorney's Office requested that the vendor either cease selling cigarettes in Alaska and file the required Jenkins Act reports for previous sales, or come into compliance with the act by filing all past and future Jenkins Act reports. In another letter dated December 1998, the U.S. Attorney's Office instructed the vendor to immediately comply with all requirements of the Jenkins Act. However, an official at the Alaska Department of Revenue told us that the vendor never complied. No further action has been taken.
- Another investigation, carried out in 1999, involved a Native American tribe selling cigarettes on the Internet directly to consumers and other tribes. The tribe was not paying state tobacco excise taxes or notifying states of cigarette sales to other than wholesalers, as required by the Jenkins Act. ATF referred the case to the state of Arizona, where it was resolved with no criminal charges filed by obtaining the tribe's agreement to comply with Jenkins Act requirements.
- A third ATF investigation of an Internet vendor for cigarette smuggling and Jenkins Act violations was ongoing at the time of our work.

ATF officials said that because ATF does not have primary Jenkins Act jurisdiction, it has not committed resources to investigating violations of the act. However, the officials said strong consideration should be given to transferring primary jurisdiction for investigating Jenkins Act violations from the FBI to ATF. According to ATF, it is responsible for, and has committed resources to, regulating the distribution of tobacco products and investigating trafficking in contraband tobacco products. A change in Jenkins Act jurisdiction would give ATF comprehensive authority at the federal level to assist states in preventing the interstate distribution of cigarettes resulting in lost state cigarette taxes since ATF already has investigative au-

[7] Certain persons, including permit holders under the Internal Revenue Code, common carriers with proper bills of lading, or individuals licensed by the state where the cigarettes are found, may possess these cigarettes (18 U.S.C. 2341).

[8] The U.S. Attorney's Office determined there was no CCTA violation because the state of Alaska did not require that tax stamps be placed on cigarette packages as evidence that state taxes were paid.

thority over the CCTA, according to the officials. The officials also told us ATF has special agents and inspectors that obtain specialized training in enforcing tax and criminal laws related to tobacco products, and, with primary jurisdiction, ATF would have the investigative authority and would use resources to specifically conduct investigations to enforce the Jenkins Act, which should result in greater enforcement of the act than in the past.

STATES HAVE TAKEN ACTION TO PROMOTE JENKINS ACT COMPLIANCE BY INTERNET CIGARETTE VENDORS, BUT RESULTS WERE LIMITED

Officials in nine states that provided us information all expressed concern about Internet cigarette vendors' noncompliance with the Jenkins Act and the resulting loss of state tax revenues. For example, California officials estimated that the state lost approximately $13 million in tax revenue from May 1999 through September 2001, due to Internet cigarette vendors' noncompliance with the Jenkins Act. Overall, the states' efforts to promote compliance with the act by Internet vendors produced few results. Officials in the nine states said that they lack the legal authority to successfully address this problem on their own. They believe greater federal action is needed, particularly because of their concern that Internet cigarette sales will continue to increase with a growing and substantial negative effect on tax revenues.

States' Efforts Produced Limited Results

Starting in 1997, seven of the nine states had made some effort to promote Jenkins Act compliance by Internet cigarette vendors. These efforts involved contacting Internet vendors and U.S. Attorneys' Offices. Two states had not made any such efforts.

Six of the seven states tried to promote Jenkins Act compliance by identifying and notifying Internet cigarette vendors that they are required to report the sale of cigarettes shipped into those states. Generally, officials in the six states learned of Internet vendors by searching the Internet, noticing or being told of vendors' advertisements, and by state residents or others notifying them. Five states sent letters to the identified vendors concerning their Jenkins Act reporting responsibilities, and one state made telephone calls to the vendors.

After contacting the Internet vendors, the states generally received reports of cigarette sales from a small portion of the vendors notified.[9] The states then contacted the state residents identified in the reports, and they collected taxes from most of the residents contacted. When residents did not respond and pay the taxes due, the states carried out various follow-up efforts, including sending additional notices and bills, assessing penalties and interest, and deducting amounts due from income tax refunds. Generally, the efforts by the six states to promote Jenkins Act compliance were carried out periodically and required few resources. For example, a Massachusetts official said the state notified Internet cigarette vendors on five occasions starting in July 2000, with one employee working a total of about 3 months on the various activities involved in the effort.

Table 1 summarizes the six states' efforts to identify and notify Internet cigarette vendors about the Jenkins Act reporting requirements and shows the results that were achieved. There was little response by the Internet vendors notified. Some of the officials told us that they encountered Internet vendors that refused to comply and report cigarette sales after being contacted. For example, several officials noted that Native Americans often refused to report cigarette sales, with some Native American vendors citing their sovereign nation status as exempting them from the Jenkins Act, and others refusing to accept a state's certified notification letters. Also, an attorney for one vendor informed the state of Washington that the vendor would not report sales because the Internet Tax Freedom Act relieved the vendor of Jenkins Act reporting requirements.

[9] Cigarette vendors are not required to report to a state unless they sell and ship cigarettes into the state. Consequently, the states do not know if the Internet vendors that were notified but did not respond had any cigarette sales to report.

Table 1: Summary of Six States' Efforts to Promote Jenkins Act Compliance Since 1997

State	Number of Internet vendors identified and notified	Number of Internet vendors that responded with reports of cigarette sales	Number of residents identified and notified	Number of residents that responded	Amount of taxes, penalties, and interest collected[a]
Alaska	15[b,c]	2	3	1	$9,850
California	167 (approx.) [c,d]	20 (approx.)	23,500 (approx.)	13,500 (approx.)	$1.4 million (approx.)
Massachusetts	262	13	None[e]	None	None
Rhode Island	Number unknown	None[f]	None	None	None
Washington	186	8	800 (approx.)	560 (approx.)	$29,898
Wisconsin	21	6	696	696	$80,200

Source: Developed by GAO from states' data.

Note: Massachusetts' data are as of May 2002, Washington's and Wisconsin's data are as of April 2002, Alaska's and Rhode Island's data are as of March 2002, and California's data are through September 2001.

[a] Not all states collected penalties and interest, and some of the amounts paid include sales and use taxes in addition to cigarette excise taxes. Some of the amounts paid by residents were for more cigarette purchases than the vendors reported to the state.

[b] Alaska identified 17 vendors, but did not know where 2 were located and could not notify them.

[c] Alaska and California sent ATF a copy of each letter mailed to Internet cigarette vendors notifying them of their Jenkins Act reporting responsibilities.

[d] California started its Internet/Mail Order Program in May 1999. Through September 2001, 196 vendors had been identified and notified, of which about 85 percent, or approximately 167, were Internet vendors. All 20 vendors that responded were Internet vendors.

[e] At the time of our work, Massachusetts had not notified the residents identified in reports provided by the 13 vendors that responded out of the 262 vendors notified because the state was in the process of developing policy regarding Jenkins Act compliance and reports of residents' Internet cigarette purchases.

[f] No Internet cigarette vendors reported cigarette sales in response to Rhode Island notifying them of their Jenkins Act reporting responsibilities.

Apart from the states' efforts to identify and notify Internet cigarette vendors, state officials noted that some Internet vendors voluntarily complied with the Jenkins Act and reported cigarette sales on their own. The states subsequently contacted the residents identified in the reports to collect taxes. For example, a Rhode Island official told us there were three or four Internet vendors that voluntarily reported cigarette sales to the state. On the basis of these reports, Rhode Island notified about 400 residents they must pay state taxes on their cigarette purchases and billed these residents over $76,000 (the Rhode Island official who provided this information did not know the total amount collected). Similarly, Massachusetts billed 21 residents for cigarette taxes and collected $2,150 based on reports of cigarette sales voluntarily sent to the state.

Three of the seven states that made an effort to promote Jenkins Act compliance by Internet cigarette vendors contacted U.S. Attorneys and requested assistance. The U.S. Attorneys, however, did not provide the assistance requested. The states' requests and responses by the U.S. Attorneys' Offices are summarized below.

- In March 2000, Iowa and Wisconsin officials wrote letters to three U.S. Attorneys in their states requesting assistance. The state officials asked the U.S. Attorneys to send letters to Internet vendors the states had identified, informing the vendors of the Jenkins Act and directing them to comply by reporting cigarette sales to the states. The state officials provided a draft letter and offered to handle all aspects of the mailings. The officials noted they were asking the U.S. Attorneys to send the letters over their signatures because the Jenkins Act is a federal law and a statement from a U.S. Attorney would have more impact than from a state official. However, the U.S. Attorneys did not provide the assistance requested. According to Iowa and Wisconsin officials, two U.S. Attorneys' Offices said they were not interested in helping, and one did not respond to the state's request.[10]
- After contacting the FBI regarding an Internet vendor that refused to report cigarette sales, saying that the Internet Tax Freedom Act relieved the vendor of Jenkins Act reporting requirements, the state of Washington acted on the FBI's recommendation and wrote a letter in April 2001 requesting that the U.S. Attorney initiate an investigation. According to a Washington official, the U.S. Attorney's Office did not pursue this matter and noted that a civil remedy (i.e., lawsuit) should be sought by the state before seeking a criminal action. At the time of our work, the state was planning to seek a civil remedy.
- In July 2001, the state of Wisconsin wrote a letter referring a potential Jenkins Act violation to the U.S. Attorney for prosecution. According to a Wisconsin official, this case had strong evidence of Jenkins Act noncompliance—there were controlled and supervised purchases made on the Internet of a small number of cartons of cigarettes, and the vendor had not reported the sales to Wisconsin. The U.S. Attorney's Office declined to initiate an investigation, saying that it appeared this issue would be best handled by the state "administratively." The Wisconsin official told us, however, that Wisconsin does not have administrative remedies for Jenkins Act violations, and, in any case, the state cannot reach out across state lines to deal with a vendor in another state.

States Concerned about Internet Vendors' Noncompliance and Believe Greater Federal Action Is Needed

Officials in each of the nine states expressed concern about the impact that Internet cigarette vendors' noncompliance with the Jenkins Act has on state tax revenues. The officials said that Internet cigarette sales will continue to grow in the future and are concerned that a much greater and more substantial impact on tax revenues will result. One state, California, estimated that its lost tax revenue due to noncompliance with the Jenkins Act by Internet cigarette vendors was approximately $13 million from May 1999 through September 2001.[11]

Officials in all nine states said that they are limited in what they can accomplish on their own to address this situation and successfully promote Jenkins Act compliance by Internet cigarette vendors. All of the officials pointed out that their states

[10] DOJ noted that federal prosecutors generally do not issue advisory opinions about prosecutive matters, as they may subsequently be presented with the need to make an actual decision based on specific facts. The issuance of such an opinion might create the basis for a legal dispute if a subsequent prosecution were undertaken.

[11] The Excise Taxes Division, California State Board of Equalization, did not make an official analyses of lost revenue. The $13 million estimate is a projection by the division based on the amount of state excise and use taxes determined as due from cigarette sales reported by out-of-state Internet vendors during the period of May 1999 through Sept. 2001.

lack the legal authority necessary to enforce the act and penalize the vendors who violate it, particularly with the vendors residing in other states. Officials in three states told us that efforts to promote Jenkins Act compliance are not worthwhile because of such limitations, or are not a priority because of limited resources.

Officials in all nine states said that they believe greater federal action is needed to enforce the Jenkins Act and promote compliance by Internet cigarette vendors. Four state officials also said they believe ATF should have primary jurisdiction to enforce the act. One official pointed out that his organization sometimes dealt with ATF on tobacco matters, but has never interacted with the FBI. Officials in the other five states did not express an opinion regarding which federal agency should have primary jurisdiction to enforce the act.

MOST INTERNET CIGARETTE VENDORS DO NOT COMPLY WITH THE JENKINS ACT OR NOTIFY CONSUMERS OF THEIR RESPONSIBILITIES

Through our Internet search efforts, we identified 147 Web site addresses for Internet cigarette vendors based in the United States and reviewed each website linked to these addresses.[12] Our review of the Web sites found no information suggesting that the vendors comply with the Jenkins Act. Some vendors cited reasons for not complying that we could not substantiate. A few Web sites specifically mentioned the vendors' Jenkins Act reporting responsibilities, but these Web sites also indicated that the vendors do not comply with the act. Some Web sites provided notice to consumers of their potential state tax liability for Internet cigarette purchases.

Majority of Web sites Indicate that Vendors Do Not Comply with the Jenkins Act

None of the 147 Web sites we reviewed stated that the vendor complies with the Jenkins Act and reports cigarette sales to state tobacco tax administrators.[13] Conversely, as shown in table 2, information posted on 114 (78 percent) of the Web sites indicated the vendors' noncompliance with the act through a variety of statements posted on the sites. Thirty-three Web sites (22 percent) provided no indication about whether or not the vendors comply with the act.

Table 2: Web sites Indicating Internet Cigarette Vendors' Noncompliance with the Jenkins Act

Web site statement indicating noncompliance	Number	Percent
Do not report sales to state tax authorities	44[a]	30
Do not comply with the Jenkins Act	1	1
Keep customer information private	43	29
Silent on reporting, but claim cigarettes are tax-free	26	18
Total	**114**	**78**

Source: GAO's analysis of Web site data.

[a]One Web site stated that it does not report to state tax authorities and that it does not comply with the Jenkins Act. In determining the number of Web sites indicating noncompliance with the Jenkins Act, we counted this only as a statement that it does not comply with the act.

Reasons Cited for Noncompliance with the Jenkins Act

Some Internet vendors cited specific reasons on their Web sites for not reporting cigarette sales to state tax authorities as required by the Jenkins Act. Seven of the Web sites reviewed (5 percent) posted statements asserting that customer information is protected from release to anyone, including state authorities, under privacy laws. Seventeen Web sites (12 percent) state that they are not required to report information to state tax authorities and/or are not subject to the Jenkins Act report-

[12] The 147 Web site addresses appear to represent 122 different Internet cigarette vendors. We made this determination by comparing information such as vendor names, company names, street addresses, P.O. box numbers, and telephone numbers. For example, some Web sites had the same mailing address and telephone number, suggesting they were separate Web sites being operated by one company.

[13] Two Web sites posted statements indicating that customer information would be released if required; however, both sites also stated that the information would not be given out without the customers' permission. The Jenkins Act does not require cigarette sellers to notify customers regarding whether or not they comply with the act's reporting requirements.

ing requirements. Fifteen of these 17 sites are Native American, with 7 of the sites specifically indicating that they are exempt from reporting to states either because they are Native American businesses or because of their sovereign nation status. In addition, 35 Native American Web sites (40 percent of all the Native American sites we reviewed) indicate that their tobacco products are available tax-free because they are Native American businesses.[14]

To supplement our review of the Web sites, we also attempted to contact representatives of 30 Internet cigarette vendors, and we successfully interviewed representatives of 5.[15] One of the 5 representatives said that the vendor recently started to file Jenkins Act sales reports with one state.[16] However, the other 4 said that they do not comply with the act and provided us with additional arguments for noncompliance. Their arguments included an opinion that the act was not directed at personal use. An additional argument was that the Internet Tax Freedom Act[17] supercedes the obligations laid out in the Jenkins Act.

Our review of the applicable statutes indicates that neither the Internet Tax Freedom Act nor any privacy laws exempt Internet cigarette vendors from Jenkins Act compliance. The Jenkins Act has not been amended since minor additions and clarifications were made to its provisions in 1953 and 1955; and neither the Internet Tax Freedom Act nor any privacy laws amended the Jenkins Act's provisions to expressly exempt Internet cigarette vendors from compliance. With regard to the Internet Tax Freedom Act, the temporary ban that the act imposed on certain types of taxes on e-commerce did not include the collection of existing taxes, such as state excise, sales, and use taxes.

Additionally, nothing in the Jenkins Act or its legislative history implies that cigarette sales for personal use, or Native American cigarette sales, are exempt. In examining a statute, such as the Jenkins Act, that is silent on its applicability to Native American Indian tribes, courts have consistently applied a three-part analysis. Under this analysis, if the act uses general terms that are broad enough to include tribes, the statute will ordinarily apply unless (1) the law touches "exclusive rights of self-governance in purely intramural matters;" (2) the application of the law to the tribe would abrogate rights guaranteed by Indian treaties; or (3) there is proof by legislative history or some other means that Congress intended the law not to apply to Indians on their reservations. Our review of the case law did not locate any case law applying this analysis to the Jenkins Act. DOJ said that it also could not locate any case law applying the analysis to the Jenkins Act, and DOJ generally concluded that an Indian tribe may be subject to the act's requirements. DOJ noted, however, that considering the lack of case law on this issue, this conclusion is somewhat speculative. ATF has stated that sales or shipments of cigarettes from Native American reservations are not exempt from the requirements of the Jenkins Act.[18]

Few Web sites Provide Notice of the Vendors' Reporting Responsibilities, but Some Provide Notice of Customer Cigarette Tax Liability

Only 8 (5 percent) of the 147 Web sites we reviewed notified customers that the Jenkins Act requires the vendor to report cigarette sales to state tax authorities, which could result in potential customer tax liability. However, in each of these cases, the Web sites that provided notices of Jenkins Act responsibilities also followed the notice with a statement challenging the applicability of the act and indicating that the vendor does not comply. Twenty-eight Web sites (19 percent) either provided notice of potential customer tax liability for Internet cigarette purchases or recommended that customers contact their state tax authorities to determine if they are liable for taxes on such purchases. Three other sites (2 percent) notified customers that they are responsible for complying with cigarette laws in their state, but did not specifically mention taxes. Of the 147 Web sites we reviewed, 108 (73 percent) did not provide notice of either the vendors' Jenkins Act reporting responsibilities or the customers' responsibilities, including potential tax liability, with regard to their states.

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[14] Fifty-nine percent, or 87, of the 147 Web site addresses reviewed are either Native American-owned or located and/or operated on Native American lands.

[15] We were either unable to reach representatives of the remaining 25 vendors we selected to conduct structured interviews, or they declined to answer questions.

[16] The vendor who said that he does comply with the Jenkins Act told us that he recently started to file reports with the state of Washington after receiving a notice from the state's Department of Revenue. However, he said Washington is the only state he reports to, and he declined to provide us with evidence of his compliance with the act.

[17] P.L. 105–277, Div. C, Title XI, Oct. 21, 1998.

[18] *Industry Circular,* No. 99–2, Bureau of Alcohol, Tobacco and Firearms, June 6, 1999.

CONCLUSIONS

Our report concluded that states are hampered in attempting to promote Jenkins Act compliance because they lack authority to enforce the act. In addition, violation of the act is a misdemeanor, and U.S. Attorneys' reluctance to pursue misdemeanor violations could be contributing to limited enforcement. Transferring primary investigative jurisdiction from the FBI to ATF would give ATF comprehensive authority at the federal level to enforce the Jenkins Act and should result in more enforcement. ATF's ability to couple Jenkins Act and CCTA enforcement may increase the likelihood it will detect and investigate violators and that U.S. Attorneys will prosecute them. This could lead to improved reporting of interstate cigarette sales, thereby helping to prevent the loss of state cigarette tax revenues. Transferring primary investigative jurisdiction is also appropriate at this time because of the FBI's new challenges and priorities related to the threat of terrorism and the FBI's increased counterterrorism efforts.

To improve the federal government's efforts in enforcing the Jenkins Act and promoting compliance with the act by Internet cigarette vendors, which may lead to increased state tax revenues from cigarette sales, our report suggested that the Congress should consider providing ATF with primary jurisdiction to investigate violations of the Jenkins Act (15 U.S.C. § 375–378). In view of the fact that ATF was recently transferred from the Treasury Department to DOJ, it may now be possible for the Attorney General to administratively transfer primary Jenkins Act enforcement authority from the FBI to ATF without involving the Congress in the matter. We believe that this possibility deserves further investigation on the part of DOJ.

Mr. SMITH. Thank you, Mr. Jones. Without objection, we will also make the entire GAO report a part of the record as well.

Mr. Armour.

STATEMENT OF HENRY "HANK" O. ARMOUR, CHAIRMAN OF THE BOARD, NATIONAL ASSOCIATION OF CONVENIENCE STORES

Mr. ARMOUR. Good morning, Mr. Chairman. My name is Hank Armour and I am a small businessman from Olympia, Washington. As President and CEO of West Star Corporation, I own and operate 24 retail facilities in Washington State and California.

I would first like to thank Representative Green for tackling such an important issue in this legislation, the Youth Smoking Prevention and State Revenue Enforcement Act. I also would like to thank Members of the Subcommittee for inviting me to testify regarding this very important issue facing retailers, States and children across this country. I am testifying today on behalf of the National Association of Convenience Stores, NACS, where I sit as chairman of the board. I am a past president of the Washington Association of Neighborhood Stores and currently serve on its executive committee.

There are over 134,000 convenience stores operating in the United States and the District of Columbia, and they employ over 1.5 million Americans. Tobacco sales are highly important components of the convenience store industry, and while controversial tobacco is a legal product and one that is very important to our economic viability.

The convenience store industry's position is that minors should not consume tobacco and that no retailer should sell tobacco to minors. That is why the convenience store operators across the country have spent time and money trying to prevent these illegal sales. My company has instituted strict measures to ensure that no minor can purchase an age restricted product. A detailed list is included in my submitted testimony, but I want to take just a few minutes to review some of the measures that we have instituted.

They include training sales associates in the "We Card" program on the very first day of employment. We recertify every sales associate every 6 months. We prominently post "We Card" signs and decals in all of our stores. We conduct monthly internal sting operations to ensure compliance with our age restricted product sales policies. We have reprogrammed our cash registers to prompt sales associates to check for ID every time an age restricted product is scanned. And finally we have a zero tolerance policy in which we immediately terminate a sales associate if the sales associate sells cigarettes to a minor.

As you can see, we take our responsibility very seriously. While no system is perfect, through these training efforts retailers have been able to significantly increase their compliance rate with regard to age verification at point of sale.

Brick and mortar retailers such as myself who have spent time and money on these responsible tobacco retailing efforts are at an unfair disadvantage to Internet, mail order, and other remote retailers. I am not asking for a weakening of our enforcement obligation, I am asking for our obligation to apply equally to all tobacco retailers. In my view, these remote retailers are frankly irresponsible. For many of these remote sellers, especially Internet retailers, age verification is simply a joke. As you can see from the Web sites I have submitted with my testimony, all a child has to do is click on a link verifying that he or she is over 18 years old, and the child can buy cigarettes. This lackadaisical age verification wouldn't fly in Washington State and I don't think any other State would allow a convenience store owner to place a sign in the store that says by asking for cigarettes you are verifying that you are 18 years old.

According to Clara York, an employee of cigarette retailers Seneca Cigarettes, the ultimate responsibility for making sure teenagers do not purchase cigarettes lies with parents, who should make an effort to police the Web sites their children are visiting. Unlike Clara York, as a responsible tobacco retailer I believe it is my responsibility and the responsibility of my sales associates to ensure that kids don't purchase cigarettes at my retail locations.

Beyond age verification remote sellers are evading tax obligations. I operate stores in Washington State and California. Both States have high excise taxes. Washington has an excise tax of $14.25 per carton. Because they don't collect State taxes remote sellers can offer their cigarettes for almost $15 less per carton than what I can. When you add in sales tax that amount approaches $20 per carton. And like many other States, Washington is currently considering another $5 per carton increase in State excise taxes. As more and more States raise their State excise taxes, smokers will be driven to these remote sellers for cheaper cigarettes.

Mr. GREEN. [Presiding.] If you could summarize your testimony. I know your light isn't operating there.

Mr. ARMOUR. While the legislation being considered today will not address every problem relating to cigarette sales, it is a good place to start. We can make a big difference by addressing the egregious violations committed every day by Internet and other remote retailers. All tobacco retailers should have to play by the same rules. And Mr. Green, your legislation will accomplish this

goal. This is a fair and balanced approach to a growing problem in our society. I thank you, Mr. Green, for introducing the Youth Smoking Prevention and State Revenue Enforcement Act and would be happy to answer any questions.

[The prepared statement of Mr. Armour follows:]

PREPARED STATEMENT OF HENRY O. ARMOUR

Good morning, Mr. Chairman. My name is Hank Armour, and I am a small businessman from Olympia, Washington. As president and CEO of West Star Corporation, I own and operate twenty-four retail facilities in Washington State and California.

I would first like to thank Representative Green for tackling such an important issue in his legislation, the Youth Smoking Prevention and State Revenue Enforcement Act. I also would like to thank members of the subcommittee for inviting me to testify regarding this very important issue facing retailers, states and children across this country.

I am testifying today on behalf of the National Association of Convenience Stores ("NACS"), where I sit as Chairman of the Board. I am a Past President of the Washington Association of Neighborhood Stores and currently serves on its Executive Committee.

There are over 134,000 convenience stores operating in the United States and the District of Columbia that employ over 1.5 million Americans. Tobacco sales are a highly important component of the convenience store industry. Convenience stores sell more than half of the single packs of tobacco sold in the United States in more than 20 million transactions per day. Such sales, on average, constituted nearly 40 percent of the in-store sales at retail locations in 2001. While controversial, tobacco is a legal product and one that is important to the economic viability of the convenience store industry.

The convenience store industry's position is that minors should not consume tobacco and that no retailer should sell tobacco to minors. That is why convenience store operators across the country have spent time and money trying to prevent tobacco these illegal sales. These prevention efforts include employee training, signage, company-operated stings, incentives for employees, and enforcement of company policies. Some retailers have even installed electronic age verification (EAV) devices to help eliminate these sales. My company has instituted the following measures to ensure that no minor can purchase an age- restricted product from my stores:

- On the first day of employment a sales associate is trained in the We Card program and is fully informed of our zero tolerance policy towards the sale of cigarettes to minors.
- Throughout the first two weeks of employment sales associates complete computer based training modules on a daily basis including one on the sales of age-restricted products.
- Every six months sales associates complete a re-certification computer based training module dealing with the sales of age-restricted products.
- We Card signs and decals are prominently posted in all of our stores.
- We conduct on a monthly basis internal sting operations to insure that sales of age-restricted products are been made appropriately.
- We publicize appropriate ID checking during sting operations in our monthly newsletter.
- We have programmed our cash registered to prompt the sales associate to check for ID every time an age restricted product is scanned for sale.
- And finally, as I mentioned earlier, we have a zero tolerance policy towards the sale of age-restricted products to minor in which we immediately terminate a sales associate if they sell such products to a minor.

As you can see, we take our responsibility very seriously.

In order to assist in the elimination of tobacco sales to minors, retailers, wholesalers and manufacturers formed in 1996 the Coalition for Responsible Tobacco Retailing. This Coalition developed the *"We Card"* training program, which provides education and training to help retailers prevent underage tobacco sales. The program includes development and disseminations of retailer best practices to tobacco retailers across the country. The *"We Card"* training materials include signage, training videos, training guides, posters, interactive on-line training, and daily re-

minder calendars. Nearly 800,000 *"We Card"* kits were distributed to retailers nationwide between 1996 and 2001. *"We Card"* offers on average 200 classroom training sessions that train almost 10,000 retailers annually. From 1996 to 2001, nearly 60,000 retailers underwent *"We Card"* classroom training and they, in turn, trained more than 700,000 employees. While no system is perfect through these training efforts, retailers have been able to significantly increase their compliance rates with regards to age verification at point of sale.

Brick-and-mortar retailers, such as myself, who have spent time and money on these responsible tobacco-retailing efforts are at an unfair disadvantage to Internet, Mail order and other remote retailers. We pay to train our employees, we get stung and have to pay fines if an illegal sale is made, and these remote sellers have none of these obligations. I am not asking for a weakening of our enforcement obligation, I am asking for our obligations to apply equally to all tobacco retailers. In my view, these remote retailers are frankly irresponsible. A good majority do not have a consistent or reliable age verification processes and should be made to conform with state tobacco retailing regulations. For many of these remote sellers, especially those Internet retailers, age verification is a joke. As you can see from the websites I've submitted with my testimony, all a child has to do is click on a link verifying and that he/she is over 18 years old and the child can buy cigarettes. This lackadaisical age verification wouldn't fly in Washington State, and I don't think any other state would allow a convenience store owner to place a sign in the store that states, "By asking for cigarettes you are verifying that you are 18 years old." According to Clara York, an employee of cigarette e-tailer Seneca Cigarettes, "the ultimate responsibility for making sure teenagers do not purchase cigarettes, lies with parents who should make an effort to police the Web sites their children are visiting." As a responsible tobacco retailer I believe it is my responsibility and the responsibility of my sales associates to ensure kids don't purchase cigarettes at my retail locations.

Beyond age verification, remote sellers are evading their tax obligations. I operate stores in Washington State and California - two states that have high excise taxes. Both states have excise taxes that are close to $1.50 per pack. Because they don't collect states taxes, remote sellers can offer their cigarettes for $15 less per carton than I can. When you add in sales taxes that such sellers do not collect, the amount approaches $20/carton. And Washington State, as are many other states across the nation, is currently considering another $5/carton increase in the state excise tax. As more and more states raise their state excise taxes, smokers will be driven to these remote sellers for cheaper cigarettes.

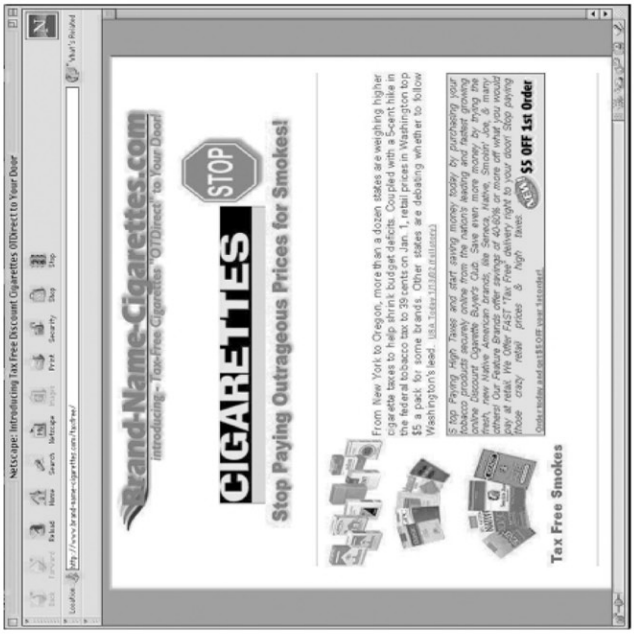
Retailers in the convenience store industry cannot compete with remote sellers who are not complying with their tax obligations—many of which flaunt their "so called" tax-free status. It simply is not a level playing field. On its home page, Seneca Smokes states that it does not report to any state taxation or tobacco department. Brand Name Cigarettes' advertising tells smokers to stop paying high taxes and start saving money today by purchasing tobacco products securely online. Just look at some of the website names: NoCigaretteTaxes.com, taxfreecigarettes.com, Cheapsmokesbymail.com, Cigs4free.com, dirtcheapcig.com, and notaxsmokes.com. The problem is not solely with Internet retailers, Big Indian Smoke Shop is buying advertisements in papers highlighting their tax-free cigarettes - the one attached to my testimony ran in a New York City paper right after the tobacco excise tax was increased.

While the legislation being considered today will not address every problem relating to cigarettes sales, it is a good place to start. We can make a big difference by addressing the egregious violations committed everyday by Internet and other remote retailers.

The convenience store industry is not asking for special treatment. We want all tobacco retailers to have to play by the same rules, and Mr. Green's legislation will help accomplish this goal. We want a level playing field. This bill will allow attorneys general to go after those remote sellers, including those that are out-of- state or run by Native Americans, who are violating the law. This is a fair and balanced approach to a growing problem in our society.

I thank Mr. Green for introducing the Youth Smoking Prevention and State Revenue Enforcement Act, and would be happy to answer any questions.

ATTACHMENT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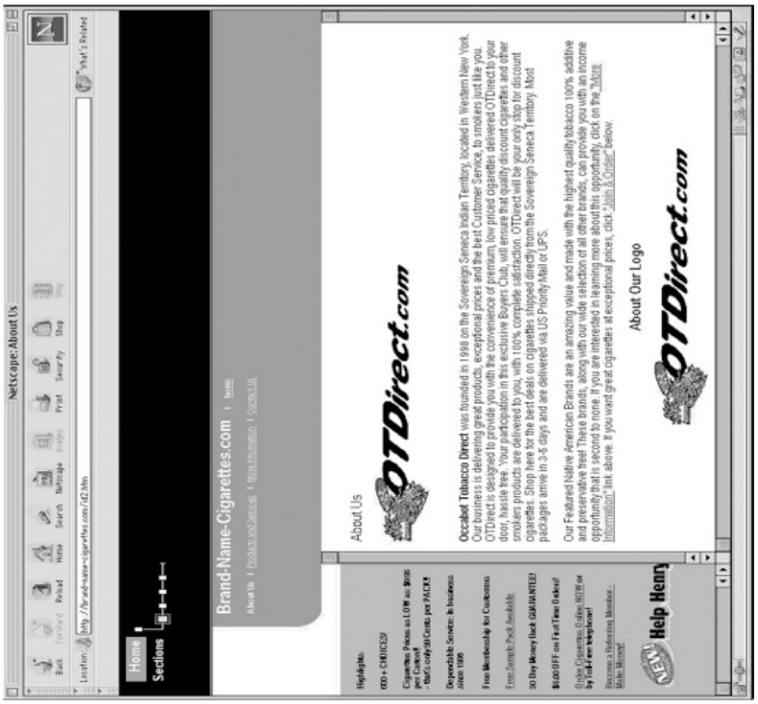
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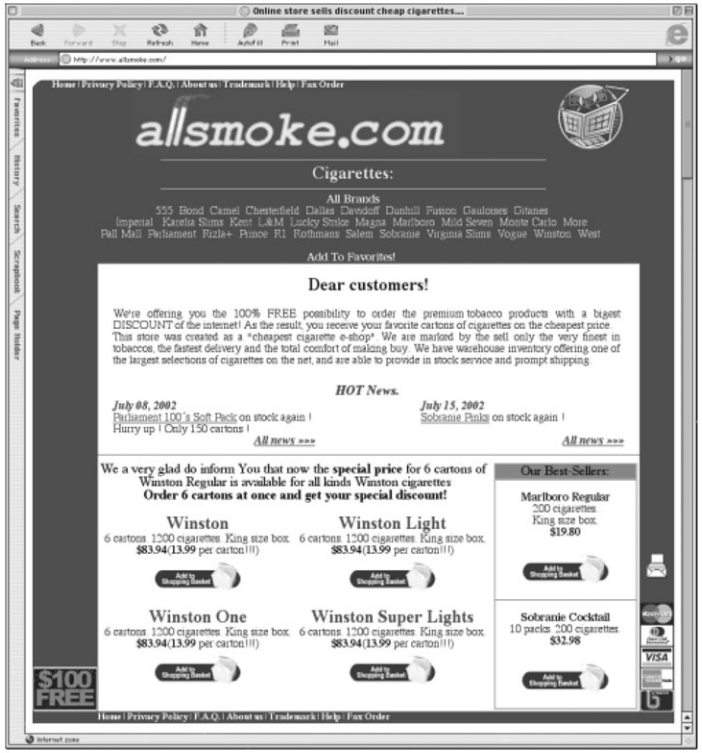
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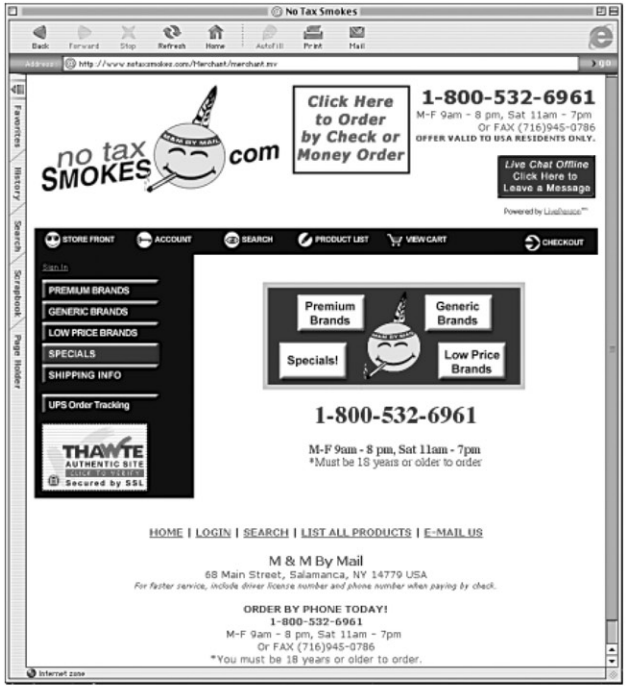
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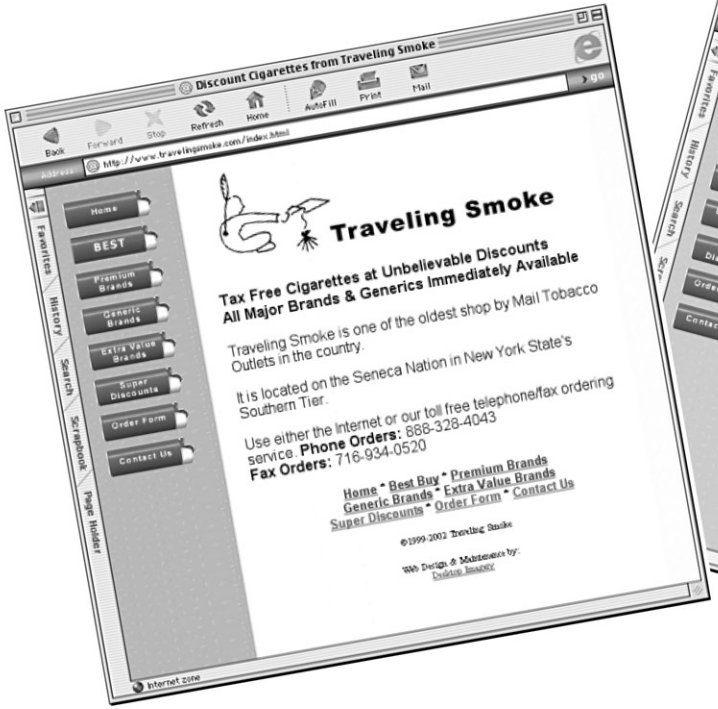
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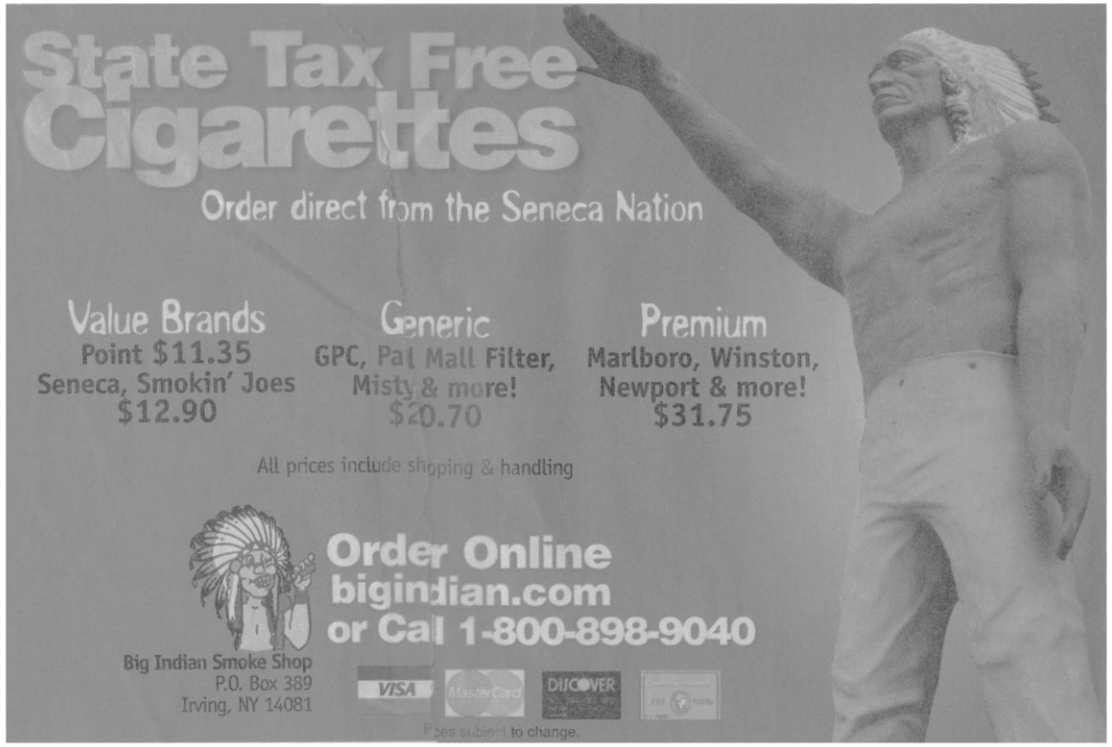
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Mr. GREEN. Thank you, Mr. Armour, for your testimony.

Mr. Myers, President for the National Center for Tobacco-Free Kids. Welcome.

STATEMENT OF MATTHEW MYERS, PRESIDENT, NATIONAL CENTER FOR TOBACCO-FREE KIDS

Mr. MYERS. Thank you. I want to start out by thanking Congressman Green for introducing this legislation and prompting this important dialogue. I also want to thank Congressman Meehan for his long time leadership on these issues and his effort to find realistic solutions to a serious problem. I am hoping that today's hearing can in fact be the kickoff to a dialogue that will lead to the enactment of legislation that will make a real difference. We ought to be able to get there.

It is clear from the discussion this morning that we agree on goals, that we need to do more to prevent youth access to tobacco products over the Internet and that we need to do something to give the State officials the tools to make sure that State taxes on tobacco products are in fact collected, both because if we fail to do so it undercuts efforts to reduce youth tobacco use and at this time more than any time in our recent past States need the funds if they are going to succeed.

That is critically important.

We agree on the problem.

We agree that State taxes are currently being evaded on a rampant basis and that unless State officials are given new tools that nothing they can do will make a significant difference.

We agree on the need for action.

We agree that the twin problems of youth access and tax evasion need to be addressed, preferably in one bill, but if not in one bill, then in two bills with realistic solutions.

We agree that the Jenkins Act has been a failure, not that it was not well intended, but it simply didn't give the Federal and State officials the tools they need.

We agree that there is a desire not to create a new bureaucracy, unfunded mandates or unnecessary burdensome provisions.

We also agree that if we are going to pass legislation we must give the State attorneys general the tools they actually need to make a real difference.

In that area, our testimony is designed to focus on what we think needs to be added to this bill so that the State attorneys general will be able to do the jobs, so they will be able to stop the hemorrhaging of State revenues.

Let me tick off in the limited time available the key areas that we think need to be addressed.

First, it is essential that this bill deal with all tobacco products. By leaving out some tobacco products we unintentionally encourage the sale over the Internet of others.

We should create an even playing field. We are not talking about adding new taxes, we are only talking about making sure that people who sell tobacco products comply with the tax laws that are already in existence.

Second, it is absolutely clear talking to law enforcement officials around the country that unless the bill clearly and unambiguously

makes it the responsibility of the seller to collect and pay the taxes, then enforcement efforts will inevitably fail. We cannot go after every kid or person who purchases a tobacco product. No law enforcement official in the Nation has those kinds of resources. I believe it is the intent of this bill to do so. But when you compare the provisions of this bill with what is needed it is clear that there needs to be an amendment. It is a simple process to make explicit that it is the obligation of the seller to collect and remit those taxes to the State officials prior to shipping the tobacco products into the State if we are going to succeed. If we don't include that kind of explicit language, everything else we do is doomed to failure.

Third, we have to make sure that the State officials are given the tools they need to enforce those provisions. What do we mean? Record keeping provisions on the part of sellers, the kind of things that the people in state, the bricks and mortar people have to comply with. The authority of State officials to block the shipment of cigarettes in from repeat offenders. It won't be enough if you simply go after the taxes time and time again. Just as you would with a repeat seller who violates the law, you need the authority to prohibit those people from selling tobacco products. And third, this bill already contains a notice provision. What it needs to make clear is that out of State sellers shouldn't be allowed to sell in State until they have filed with the State, so that the State officials don't have to go on a search for a needle in a haystack to figure out who is violating the law.

Next, the enforcement provisions have to be adequate. Otherwise State officials won't have the incentive to do so. What that means is significant enough minimum penalties just as retailers face so that people will have an incentive both to obey the law and the law enforcement officials will have the incentive to enforce the law. The bill I think unintentionally strips the Federal officials of its Federal authority. We should be adding to those.

Last, let me just add something that Congressman Meehan said. We need to make sure that the criminal penalties here are real and that they can be enforced both by Federal and State officials. If we do those things, this is a law enforcement bill that can have a significant public health impact on our children and can help States prevent the continued hemorrhage from the illegal sale of tobacco products.

Thank you. Congressman Green, we are very sincere in our offer that we would like to work with you to have a bill that can pass this Congress with bipartisan support in an overwhelming vote.

[The prepared statement of Mr. Myers follows:]

PREPARED STATEMENT OF MATTHEW MYERS

Good morning Mr. Chairman, and members of the Committee. My name is Matthew Myers. I am the President of the National Center for Tobacco-Free Kids, a national organization created to protect children from tobacco by raising awareness that tobacco use is a pediatric disease, by changing public policies, and by actively countering the special interest influence of the tobacco industry.

Mr. Chairman, I want to thank you for inviting me to testify on draft legislation by Congressman Green. While we support the concept of providing the State Attorneys General with authority to enforce violations of this Act, regrettably, we must oppose the legislation as drafted.

Current Internet sales of tobacco raise two serious issues: uncontrolled sales to youth and evasion of state sales and tobacco related excise taxes. The twin problems

of youth access and tax evasion need to both be addressed, preferably in one bill, but if not in one bill in two bills that contain adequate provisions to make a real difference. This bill as currently drafted does not deal with the problem of sales to young people at all; and it is our assessment that its limited proposal to address the problem of the evasion of state sales and tobacco related excise taxes will be ineffective. If its enactment prevents or forestalls the passage of legislation that effectively addresses these problems, it will do more harm than good. Even worse, it would undermine the longstanding, bipartisan efforts of Congressman Meehan, former Congressman Hansen and others to enact a comprehensive solution by giving the false impression that the problems had been effectively addressed.

There are currently about 200 U.S. websites and 200 foreign-based websites that sell cigarettes to U.S. smokers. Effective safeguards against kids being able to purchase cigarettes via the Internet are almost non-existent. While many Internet websites post notices that sales to persons under 18 are illegal or not allowed, very few do anything at all to make sure such sales do not occur.

Tax evasion via Internet sales of tobacco products is rampant. Internet tobacco prices are much lower than those in regular bricks-and-mortar retail outlets because Internet prices almost never include the taxes charged by retail stores. These low prices make Internet tobacco products attractive to both adult and underage smokers, and help to boost overall smoking levels. In addition, states lose millions of dollars each year in uncollected tax revenues. All of these problems have been compounded by the inadequacy of the enforcement tools available, the most serious of which is caused by the fact that under current law responsibility for paying the state taxes is normally the responsibility of the purchaser rather than the Internet seller.

We have been skeptical about whether these problems can be fully resolved by any action short of a ban such as that imposed recently by the State of New York, but we have endorsed H.R. 5724, the Meehan/Hansen bill introduced in the last Congress. The Meehan/Hansen bill offered a comprehensive solution to the problems arising from Internet sales of tobacco products by addressing both parts of the problem: youth access and tax evasion. The American Cancer Society, the American Heart Association and the American Lung Association also endorsed H.R. 5724. To protect against Internet sales to youth, H.R. 5724 would have required the verification of age and identity both at the time of sale and the time and place of delivery.

We understand that this Committee wants to focus exclusively on legislation within its jurisdiction that addresses the fact that states are illegally losing millions of tax dollars. To accommodate that desire, we undertook to provide Congressmen Green and Meehan with a draft of such legislation. We strongly urge the Committee to adopt its provisions.

I would now like to outline the seven specific areas in which the legislation offered by Congressman Green fails to meet what we believe are the minimum standards necessary for any effective legislation dealing with Internet tobacco sales.

1. The legislation should apply to all tobacco products, not just cigarettes.

If the legislation applies only to cigarettes it will do nothing to reduce illegal sales and tax evasion over the Internet or through mail order on other tobacco products. By focusing only on cigarettes, the legislation could have the unintended consequence of encouraging use of other tobacco products such as smokeless tobacco. There can be no justification for the different treatment of different tobacco products.

2. The legislation should explicitly impose the burden of either paying or insuring that applicable state taxes are paid on the Internet seller rather than on the purchaser.

State tobacco taxes on tobacco products sold at retail are collected at the distributor level. The products arrive at the retail outlet with a tax stamp already on them and the applicable tobacco related taxes already paid. This enables law enforcement officials to easily monitor compliance and insures that violations will involve a sufficient amount of money to warrant enforcement.

At present Internet sellers based outside the United States and/or on Indian lands pay no state taxes and Internet sellers based in low tax states only pay the tax from the state in which they are based. The responsibility for paying the tax on the tobacco products they sell then falls to the individual consumer/purchaser, making enforcement difficult and costly. Unless the responsibility for paying the tax is clearly and unquestionably switched to the Internet seller, it doesn't matter who is given the authority to enforce the law—it will not happen.

Despite our requests that a provision be added that explicitly switches the responsibility to the Internet seller, the bill before the Committee does not do so. As written, the draft legislation offered by Congressman Green in Sec. 2(a) only requires that the Internet seller "comply with all the sales tax and use tax and other laws, applicable to the distribution and sale of cigarettes." This could be interpreted to give states only a federal right of action to enforce existing state laws that apply to Internet sellers. Very few states have laws that explicitly apply to Internet sellers.

Even a broader interpretation would be difficult to implement because states have numerous "sales and use tax and other laws applicable to the sale of cigarettes." Some apply to manufacturers, distributors, and wholesalers; others apply to retailers, vending machine operators, etc. In most states, state laws place no tobacco tax collection or payment obligations on retailers because these responsibilities are placed on others. If the goal is to require the Internet seller to pay the tax or to insure that it is paid, then the legislation should be explicit on this point. If legislation is ambiguous as to whether the burden to pay the tax falls on the Internet seller or purchaser or some third party, then it will be wholly ineffective in curtailing tax evasion.

3. The legislation should apply to all remote sales of tobacco products.

As written, the legislation exempts sales that are not "outside the State or Indian lands where the order is processed." While the impact is probably unintended, this could be read to exempt sales from Indian lands to consumers outside the Indian reservation but within the same state. This could be a substantial loophole in states with large populations with in-state tribal Internet sellers.

4. The legislation should include an enforcement mechanism that will assure that the states can actually enforce the legislation and block Internet and mail-order sales of tobacco products for which state taxes have not been paid.

Internet sellers are often based out of state, on Tribal lands, or even offshore or overseas. Some are fly-by-night operations. Even if this legislation gives states authority to bring civil actions against any person who violates the Act, bringing state lawsuits against distant vendors is an inevitably costly, cumbersome, complicated, and ultimately uncertain enforcement procedure.

To be effective, legislation must require that Internet sellers maintain records of their sales for several years, prohibit anyone from shipping tobacco products into the state who has not registered and give the state the authority to block the delivery of tobacco products who have not complied with the law. The current draft does not adequately include any of these tools.

5. The Civil Action section of the legislation should provide for civil fines and give the federal government the right to seek civil fines and civil damages.

As drafted, Sec. 3. entitled "Civil Action" says that a State Attorney General may "obtain appropriate relief, including money damages," but does not provide for any specific or minimum penalties or fines for violating the provisions of this Act, nor does it include the authority to withdraw a repeat violator's right to sell tobacco products into the state in the future.

We support the proposal to provide state Attorneys General with the authority to bring civil actions to enforce violations of the law, but it should not at the same time strip the federal government of authority to bring a civil enforcement action and allow the federal government only to seek criminal penalties. As drafted, the federal government would not be allowed to seek any civil or monetary damages or fines from Internet or mail order sellers who break the law. Federal authorities have not to date exercised their current enforcement authority, in part, because individual enforcement cases were deemed to be too small to warrant the effort. If the law imposed the burden to pay the taxes on the Internet seller, rather than the purchaser, federal enforcement could potentially become an important complement to any state enforcement prompted by the Act.

6. The criminal penalties should be increased beyond the inadequate penalties established in the original Jenkins Act in 1949.

This legislation provides only a misdemeanor penalty with no minimum fine and a maximum fine too small to have a deterrent effect, along with up to 6 months in jail, or both. These penalties are inadequate. The penalties in the original Jenkins Act failed to deter violators or to encourage federal enforcement of the law and the provisions in the bill now before the Committee will not correct this problem. To be effective, the criminal penalty provisions should make violations of the act a

felony, provide for significant, minimum criminal fines, and provide for larger criminal fines and possible imprisonment for flagrant and repeated violations.

7. The legislation does not require Internet and mail-order sellers to keep any records of their sales and deliveries into a state.

While the legislation, like the original Jenkin's Act, requires Internet and mail-order sellers to register with state tax administrators and make monthly sales reports to those officials, it does not require them to keep their own records of these sales and deliveries over time. This omission could be a major impediment to enforcement efforts and to the calculation of monetary damages, such as unpaid taxes. A provision should be added to the legislation requiring sellers to maintain specific records for not less than five years.

In sum, this bill addresses a legitimate problem, but does not do so effectively. If the goal is to insure that state tobacco taxes are collected on Internet tobacco sales, the bill as drafted will not accomplish its purpose. We in the public health community are prepared to and would welcome the opportunity to work with the Committee to produce effective legislation that would make a reality of our common goal to reduce tax evasion and eliminate youth access to tobacco products in remote sales of tobacco products.

ATTACHMENT

INTERNET SALES OF TOBACCO PRODUCTS
– REACHING KIDS & EVADING TAXES –

The ongoing increase in internet sales of tobacco products is a major challenge to public health efforts to reduce smoking and other tobacco use. By failing to do adequate age verification, the sharply growing number of websites selling tobacco products make it easier and cheaper for kids to buy cigarettes. They also offer smokers a way to avoid paying state tobacco and sales taxes, thereby keeping cigarette prices down and smoking levels up.[1]

Internet Cigarette Sales Are Growing

There are currently about 200 U.S. websites and 200 foreign-based websites that sell cigarettes to U.S. smokers – up from approximately 40 domestic internet sellers of cigarettes in early 2000.[2] According to a recent report by Prudential Securities, Inc., internet vendors currently sell roughly two percent of all cigarettes consumed in the United States, or more than 400 million packs per year, and internet cigarette sales are likely to triple within the next three years.[3] A study by Forrester Research, Inc. (a private consulting firm) projects that internet cigarette sales will grow even more rapidly and account for 14% of the total U.S. market by 2005, or roughly $5 billion in sales.[4]

Tax Avoidance via Internet Sales

Internet cigarette prices are much lower than cigarette prices in regular bricks-and-mortar retail outlets because internet prices almost never include the cigarette excise taxes and sales taxes charged by the customers' home states. These low prices make internet cigarettes attractive to both adult and underage smokers, and help to boost overall smoking levels. In addition, the inability of states to collect the applicable state taxes that are legally owed on these cigarettes and other tobacco products sold over the internet is reducing state revenues by millions of dollars each year.

Internet sellers usually buy the cigarettes they sell in a low-tax state (e.g., VA, KY, or NC, which have state cigarette tax rates of only 2½, 3, and 5 cents per pack, respectively) or purchase them free from any state tax (e.g., by selling cigarettes obtained outside the United States free of any U.S. state or federal taxes, or obtained in the United States but still free of state tax because they are meant to be sold only to members of Indian tribes on Indian lands). The internet vendors then sell these cigarettes to smokers in higher-tax states, typically without collecting those states' taxes or making any reports of those sales to the states' tax collection officials (as required by the federal Jenkins Act).[5] Offshore websites that sell U.S. brands manufactured overseas or manufactured in the U.S. and exported for foreign sale, can also into violate federal laws requiring payment of applicable federal and state taxes on imported cigarettes.

- According to a recent report by the U.S. General Accounting Office (GAO), information posted on more than three quarters of all internet-selling website explicitly indicate that they do not comply with the Federal Jenkins Act, and state efforts to prompt compliance by internet sellers have not been successful.[6]

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- A study by Forrester Research Inc. estimates that because of internet cigarette sales the states lost as much as $200 million in state tobacco tax revenues in 2001 and may lose as much as $1.4 billion in 2005.[7]

Youth Access to Tobacco Products Sold on the Internet

Effective safeguards against kids being able to purchase cigarettes via the internet are almost non-existent. While many internet websites post notices that sales to persons under 18 are illegal or not allowed, very few do anything at all to make sure such sales do not happen.

- A study in the *American Journal of Public Health* reports that almost 20% of cigarette-selling websites do not even say anything about sales to minors being prohibited. More than half require only that the buyer say they are of legal age (e.g., by clicking on a "I am Over Age 18" button), another 15% require only that the buyer type in their date of birth, and only 7% require any driver's license information.[8]

- While some internet vendors claim that credit card use, by itself, is an adequate safeguard against underage purchases, many kids have access to credit cards and the credit card companies (which specifically market credit cards for kids) have firmly stated that credit cards are not appropriate for age verification. Moreover, more than two-thirds of websites selling tobacco products also accept money orders or checks.[9]

- Attorneys general from at least 15 states have conducted internet stings and found that children as young as 9 years of age were easily able to purchase tobacco products. A sting operation in New York found that 24 of 26 web sites sold to minors working with the New York City Department of Consumer Affairs.[10]

- In a recent study published in the *Tobacco Control* journal, kids sent in orders to internet cigarette vendors, providing a money order for the purchase but no proof of age, and only 14% of the orders were rejected because of the lack of proof of age.[11]

While existing studies show that a relatively small percentage of kids have been purchasing cigarettes through the internet, increased youth purchases are likely given the lack of effective obstacles to youth purchases and the growing differences between low internet prices and regular retail prices for cigarettes. Increased youth internet purchases are also likely in those states and localities with effective enforcement efforts to stop illegal sales by bricks and mortal retailers. In addition, internet cigarette sales typically require a two-carton minimum purchase, which suggests that many high school and middle school buyers of internet cigarettes serve as suppliers of low-cost cigarettes to other kids.

The most recent data currently available is from surveys done in 2000, which indicate that approximately 1.4 percent of high school smokers purchased their last pack from the internet, as did one percent of middle school smokers, at that time.[12] These percentages refer only to the percentage of youth smokers that purchased their last pack from the internet, ignoring those who purchased their last pack elsewhere but have previously made internet cigarette purchases. Nevertheless, these percentages still amount to well over 50,000 children in the U.S. buying tobacco products on the internet two years ago. Another study done in the 1999-2000 school year found that 2.2 percent of kids under 18 in California who were current smokers (or more than 10,000 kids) reported trying to buy cigarettes over the internet.[13]

Since these two studies collected their data, roughly 25 million more U.S. households have gained internet access. In fact, U.S. Census data shows that from 1999 to 2001 (the last year for which data is currently available) the percentage of U.S. households with internet access has increased from 26.2% to 50.5%, with households with kids more likely to have internet access than households without kids.[14] At the same time, the numbers of kids who have used the internet or made purchases on it has also grown substantially; and there has been substantial additional growth since 2001. Given the overall increases in internet access and internet purchases, especially among kids, it is likely that youth purchases of tobacco products on the internet have gone up, as well.

Other Problems with Internet Tobacco Sales

- Only a bit more than one quarter of all cigarette-selling websites display the U.S. Surgeon General's health warnings.[15]

- Besides failing to comply with the federal Jenkins Act and state laws requiring age verification prior to sale, internet sellers of tobacco products also typically fail to comply with state laws requiring all retail sellers of tobacco products to obtain licenses prior to making any sales in the states or with various other laws and regulations that regular bricks-and-mortar retailers in the states cannot avoid as readily.

- Because internet vendors of tobacco products are usually located out of state – or even out of the country – it is very difficult for state officials to enforce the state laws that apply to the internet sellers. In addition, many internet sellers of tobacco products are based on Indian Lands and run by Indian Tribes, which makes it difficult, if not impossible, for states to obtain jurisdiction over any such internet vendors that violate the law in either state or federal court.

- The many difficulties faced by states that wish to enforce their laws that apply to internet tobacco product sales is compounded by the federal government's failure, to date, to enforce the Jenkins Act against the many internet sellers that not only fail to comply but flaunt their noncompliance.[16]

National Center for Tobacco-Free Kids, November 13, 2002 / Eric Lindblom

For More Information

Campaign website's special report on internet tobacco sales: http://tobaccofreekids.org/reports/internet.

Campaign factsheet, *Tobacco Product Marketing on the internet:* http://tobaccofreekids.org/research/factsheets/index.php?CategoryID=23.

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[1] See Connolly, G, "Smokes and cyberspace: a public health disaster in the making," *Tobacco Control* 10:299 (Winter), December, 2001, http://tc.bmjjournals.com/cgi/content/full/10/4/299; Cohen, J, et al., "Tobacco commerce on the internet: a threat to comprehensive tobacco control," *Tobacco Control* 10: 364-367 (Winter), December, 2001, http://tc.bmjjournals.com/cgi/content/abstract/10/4/364.
[2] Prudential Financial, *Buying Cigarettes Over the Internet*, Research Report, Consumer Staples/Tobacco, September 24, 2002; Bryant, JR, et al., "Online Sales: Profit Without Question," *Tobacco Control* 11: 226-27, September, 2002, http://tc.bmjjournals.com/cgi/content/abstract/11/3/226 [citing Noack D, "Utah recruits kids to buy smokes online. Proposed laws would plug loopholes," *Salt*

Lake City, February 2000]. See, also, Ribisl, KM, et al., "Web sites selling cigarettes: how many are there in the USA and what are their sales practices?," *Tobacco Control* 10: 352-359 (Winter), December, 2001, http://tc.bmjjournals.com/cgi/content/abstract/10/4/352.

[3] Prudential Financial, *Buying Cigarettes Over the Internet*, September 24, 2002.

[4] Rubin, R. et al., *Online Tobacco Sales Grow, States Lose*, Forrester Research, Inc., April 27, 2001, http://www.forrester.com/ER/Research/Brief/Excerpt/0,1317,12253,00.html

[5] The Jenkins Act, 15 USC 375 et seq., is available at http://www4.law.cornell.edu/uscode/15/ch10A.html.

[6] U.S. General Accounting Office, *Internet Cigarette Sales: Giving ATF Investigative Authority May Improve Reporting and Enforcement*, GAO-02-743, August 9, 2002, http://www.gao.gov/new.items/d02743.pdf.

[7] Rubin, R. et al., *Online Tobacco Sales Grow, States Lose*, Forrester Research, Inc., April 27, 2001.

[8] Ribisl, K, et al., "Are the Sales Practices of Internet Cigarette Vendors Good Enough to Prevent Sales to Minors?," American Journal of Public Health 92(6): 940-41, June 2002, http://www.ajph.org/content/vol92/issue6/index.shtml.

[9] Unger, JB, et al., "Are adolescents attempting to buy cigarettes on the internet?," *Tobacco Control* 10: 360-63 (Winter), December, 2001, http://tc.bmjjournals.com/cgi/content/abstract/10/4/360 [citing Kim AE, et al., "Sales practices of Internet cigarette vendors: Are they adequate to prevent minors from buying cigarettes online?," Roundtable presented at the Annual Meeting and Convention of the American Public Health Association, Boston, Massachusetts, November 2000].

[10] Unger, JB, et al., "Are adolescents attempting to buy cigarettes on the internet?," *Tobacco Control* 10: 360-63 (Winter), December, 2001[citing Sherer R, "States crack down on Web tobacco sales," *The Christian Science Monitor*, November 8, 2000 & ABC News, "Getting smokes online: Children buying cigarette with click of mouse," March 6, 2001, http://www.abcnews.com.

[11] Rubin, R. et al., *Online Tobacco Sales Grow, States Lose*, Forrester Research, Inc., April 27, 2001.

[12] U.S. Centers for Disease Control and Prevention (CDC), *Youth Tobacco Surveillance – United States, 2000*, CDC Surveillance Studies, *MMWR* 50(SS-4), November 2, 2001, Table 23, http://www.cdc.gov/mmwr/PDF/ss/ss5004.pdf [according to CDC, the seemingly related national YTS internet data in Table 22 of the 2000 YTS is completely inaccurate and unusable because of survey and formatting problems].

[13] Unger, JB, et al., "Are adolescents attempting to buy cigarettes on the internet?," *Tobacco Control* 10: 360-63 (Winter), December, 2001, http://tc.bmjjournals.com/cgi/content/abstract/10/4/360.

[14] Economics and Statistics Administration & National Telecommunications and Information Administration, U.S. Department of Commerce, *A Nation Online: How Americans Are Expanding Their Use Of The Internet*, February 2002, http://www.ntia.doc.gov/ntiahome/dn/index.html.

[15] Ribisl, KM, et al., "Web sites selling cigarettes: how many are there in the USA and what are their sales practices?," *Tobacco Control* 10: 352-359, December, 2001, http://tc.bmjjournals.com/cgi/content/abstract/10/4/352.

[16] U.S. General Accounting Office, *Internet Cigarette Sales: Giving ATF Investigative Authority May Improve Reporting and Enforcement*, GAO-02-743, August 9, 2002, http://www.gao.gov/new.items/d02743.pdf.

Mr. GREEN. I look forward to it. Thank you for your testimony. The final witness today is Mr. Patrick Fleenor, Chief Economist with Fiscal Economics. Welcome.

STATEMENT OF PATRICK FLEENOR, CHIEF ECONOMIST, FISCAL ECONOMICS

Mr. FLEENOR. Mr. Chairman, Members of the Committee, as you know, over the last 5 years the retail price of cigarettes in the United States has soared. Buoyed by the rash of recent State and local excise tax hikes as well as the implicit taxes which were part of the Master Settlement Agreement, the average retail price of cigarettes has risen nearly $4 per pack, almost twice the level of just 5 years ago. In high tax jurisdictions such as New York City cigarettes can cost more than $7.50 a pack. Consumers have responded to the rising prices by increasingly searching out low cost sources of cigarettes.

One source that has experienced considerable growth over the last several years has been online tobacco retailers who sell cigarettes acquired from low-tax jurisdictions. In the year 2000 it was estimated that there were roughly 40 U.S. based Web sites selling cigarettes. Today this figure has risen to nearly 200. An equal number of foreign sites also sell cigarettes into the U.S. market.

A September 2002 study by Prudential Securities estimated that 2 percent of the cigarettes consumed in the United States, or more than 400 million packs were purchased online. The report projected this figure would triple by 2005. Another study by Forrester Research forecast that Internet sales would claim 14 percent of the market by 2005.

With State and local governments frequently collecting more than $1 in excise and sales tax revenue on each pack of cigarettes sold, Internet cigarette sales can have significant fiscal effects. I estimated—using a sophisticated economic model which first allocates Internet sales to the States and then estimates their effect on State and local revenue. The model basically applies State and local excise taxes as well as sales taxes to the number of packs sold, during the current fiscal year under the assumption that Internet sales would supply about 2 percent of the market I estimated that Internet sales would collectively cost State and local governments about $552 million in excise and sales tax revenue. This impact, however, will vary significantly by State. In New York, home of the Nation's highest cigarette taxes, Internet sales will cost State and local governments more than $150 million. It will also be high in California and New Jersey and Michigan.

On the flip side, some States will experience very little losses. Montana, for example, will lose about $41,000 this year in sales tax as well as cigarette excise taxes. Losses will also be relatively light in Wyoming, Delaware, and Colorado.

Even in the absence of additional State and local excise tax hikes, many observers feel that the share of the U.S. cigarette market supplied by Internet retailers will continue to expand over the next several years unless the tax advantage that online retailers enjoy over traditional brick and mortar retailers is significantly narrowed.

Estimates of market penetration vary significantly, so I estimated State and local revenue losses under two scenarios. The first assumed the Internet retailers would capture about 6 percent of the market by 2005. In that scenario I estimated that total excise and sales tax revenue losses by the States would equal around $1.7 billion, again the impact varying significantly by State. New York, I estimated would lose about $435 million while other States would lose as little as about $115,000.

In the second scenario I assumed Internet retailers would capture about 14 percent of the market by 2005. In that case you have losses of about $4 billion, again significant variation among the States in terms of revenue loss. Some States like New York will lose as much as a billion, others will lose around $268,000.

Proponents of a larger role for State governments in the enforcement of tobacco statutes, as we are talking about today, frequently argue that in addition to the fact that State and local governments have a greater incentive to collect their tax revenue than do Federal authorities, the widely varying impact that avoidance causes on the States calls for something more than a one-size-fits-all approach. Therefore my research tends to support the bill.

Thank you, Mr. Chairman and Members of the Committee, for the opportunity to testify this morning. I will submit a copy of my full statement for the record and be happy to take any questions.

[The prepared statement of Mr. Fleenor follows:]

PREPARED STATEMENT OF PATRICK FLEENOR

Mr. Chairman and Members of the Committee, my name is Patrick Fleenor. I am the chief economist of Fiscal Economics, a consulting firm specializing in the economic analysis of fiscal policy. Prior to my current position I was a senior economist with the Joint Economic Committee of the United States Congress. I have also served as chief economist of the Tax Foundation, one of the nation's oldest and most respected think tanks. It is an honor for me to appear before you today to discuss the impact of Internet cigarette sales on state and local government budgets.

INTRODUCTION

Over the last 5 years, the retail price of cigarettes has soared. Buoyed by the rash of recent state and local excise tax hikes as well as the implicit tax hikes which are part of the Master Settlement Agreement, the average retail price of a pack of cigarettes has risen to nearly $4.00 per pack, almost twice the level just 5 years ago. In high-tax jurisdictions such as New York City, cigarettes can cost as much as $7.50 per pack.

Consumers have responded to these rising prices by increasingly searching out low-cost sources of cigarettes. One source that has experienced considerable growth over the last several years has been online tobacco retailers who sell cigarettes acquired from low-tax jurisdictions.

In 2000, it was estimated that there were roughly 40 U.S.-based websites selling cigarettes on the Internet. Today, this figure has risen to more than 200 with an equal number of foreign sites also selling cigarettes in the U.S. market. A September 2002 study by Prudential Securities estimated that 2 percent of the cigarettes consumed in the U.S.—more than 400 million packs annually—were purchased online.[1] The report projected that this figure would triple by 2005. Another study by Forrester Research forecast that Internet cigarette sales would claim 14 percent of the U.S. market by 2005.[2]

[1] Prudential Financial, Buying Cigarettes Over the Internet, September 24, 2002.

[2] Robert Rubin, Chris Charron, and Moria Doesey, Online Tobacco Sales Grow, States Lose, Forrester Research, Inc., April 27, 2001.

ESTIMATING THE EFFECT OF INTERNET CIGARETTE SALES ON STATE & LOCAL SALES AND EXCISE TAX REVENUES BY STATE

With state and local governments frequently collecting more than $1.00 in excise and sales tax revenue on each pack of cigarettes sold, Internet cigarette sales can have significant fiscal effects. It is possible to calculate these effects by employing an economic model that apportions Internet cigarette sales by state and then uses information on sales and excise taxes as well as average price data to calculate revenue losses by jurisdiction.

This type of analysis was used to prepare the estimates presented in Table 1. Here it was assumed that Internet purchases accounted for 2.0 percent of total cigarette sales in FY 2003. Under this assumption, which is generally consistent with the estimate made in the Prudential Securities report, 413.9 million packs of cigarettes will be sold over the Internet during the 2003 fiscal year.

The allocation module of the model uses population data, smoking rates, sales and excise tax levels, and other information to calculate the demand for cigarettes as well as incentive to purchase cigarettes online. Consequently, states with similar populations can have widely differing levels of Internet sales. Total Internet sales in New York, for example, are estimated to be more than three times the level in Texas even though smoking rates in the two states are similar. This occurred in large part because the incentive to purchase cigarettes online—i.e. sales and excise taxes levied on cigarettes—were, on average, more than 3 times higher per pack in New York.

Once total Internet sales have been apportioned among the states the model calculates state and local excise and sales tax revenue lost as a result of Internet cigarette sales. The model estimates that in FY 2003 state and local governments in the U.S. will lose $552.4 million due to online cigarette sales. The bulk of these funds, $399.4 million or 72.3 percent of the total, will be due to lost excise tax collections. The balance will result from lost sales taxes.

Tables 2 and 3 present projections of state and local government revenue losses under current law for FY 2005 under two scenarios. The analysis underlying Table 2 assumes that Internet sales will capture 6 percent of the U.S. cigarette market by FY 2005, a forecast similar to that made by Prudential Securities. Under this scenario state and local governments will lose $1.7 billion in excise and sales tax revenue during that fiscal year.

The results of the analysis presented in Table 3 assume that Internet cigarette sales climb to 14 percent of the market by FY 2005, a forecast generally consistent with that made by Forrester Research. Under this assumption, state and local governments would lose roughly $4.0 billion in excise and sales tax revenue during FY 2005.

CONCLUSION

The ability of Internet retailers to sell low-tax cigarettes at a time of rapidly rising cigarette taxes has resulted in that sector supplying an ever increasing share of the nation's cigarette market in recent years. This has cost state and local governments billions of dollars in lost excise and sales tax revenue at a time of widening budget gaps. Even in the absence of additional tax hikes, many industry observers feel that the Internet sector will continue to expand over the next several years, with commensurate revenue losses for state and local governments, unless the tax advantage Internet retailers currently enjoy over traditional brick-and-mortar retailers is significantly narrowed.

Table 1
Internet Cigarette Sales and Resulting State & Local Government Cigarette Excise and Sales Tax Revenue Losses by State
FY 2003, Assumes That Internet Sales Account for 2 Percent of the Total Consumption

	Internet Cigarette Sales (Packs of 20)	State & Local Government Revenue Losses								
		State & Local			State			Local		
		Total	Excise	Sales	Total	Excise	Sales	Total	Excise	Sales
United States	413,886,457	$552,440,985	$399,405,262	$153,035,723	$499,076,167	$383,888,133	$115,188,034	$53,364,818	$15,517,128	$37,847,690
Alabama	3,599,709	2,351,675	811,936	1,539,738	1,507,526	593,952	913,574	844,148	217,984	626,164
Alaska	1,201,243	1,373,996	1,373,996	0	1,201,243	1,201,243	0	172,753	172,753	0
Arizona	9,086,680	12,354,206	8,526,543	3,827,663	11,391,550	8,526,543	2,865,007	962,656	0	962,656
Arkansas	2,653,762	1,650,163	835,935	814,228	1,467,802	835,935	631,867	182,361	0	182,361
California	49,384,217	64,171,923	42,964,269	21,207,654	59,307,277	42,964,269	16,343,008	4,864,646	0	4,864,646
Colorado	1,319,561	263,912	263,912	0	263,912	263,912	0	0	0	0
Connecticut	7,376,570	10,953,358	9,061,055	1,892,303	10,953,358	9,061,055	1,892,303	0	0	0
Delaware	328,065	78,736	78,736	0	78,736	78,736	0	0	0	0
Florida	14,557,036	8,308,824	4,934,835	3,373,989	8,190,428	4,934,835	3,255,592	118,397	0	118,397
Georgia	4,726,076	2,310,883	567,129	1,743,753	1,639,174	567,129	1,072,045	671,709	0	671,709
Hawaii	2,231,530	2,971,022	2,565,343	405,680	2,971,022	2,565,343	405,680	0	0	0
Idaho	833,579	367,232	233,402	133,830	367,232	233,402	133,830	0	0	0
Illinois	26,491,694	36,582,358	27,775,612	8,806,745	33,700,369	25,961,861	7,738,508	2,881,989	1,813,752	1,068,237
Indiana	8,771,201	6,796,647	4,868,017	1,928,630	6,796,647	4,868,017	1,928,630	0	0	0
Iowa	2,521,670	1,422,798	907,801	514,997	1,376,489	907,801	468,688	46,309	0	46,309
Kansas	3,695,007	3,710,829	2,586,505	1,124,324	3,471,851	2,586,505	885,346	238,978	0	238,978
Kentucky	1,921,254	429,330	57,638	371,692	429,310	57,638	371,673	20	0	20
Louisiana	4,564,251	4,314,382	1,596,612	2,717,769	2,891,787	1,596,612	1,295,175	1,422,594	0	1,422,594
Maine	2,499,368	2,898,699	2,335,574	563,125	2,898,699	2,335,574	563,125	0	0	0
Maryland	6,830,340	6,084,448	4,698,899	1,385,548	6,084,448	4,698,899	1,385,548	0	0	0
Massachusetts	14,922,401	25,505,390	21,796,927	3,708,463	25,505,390	21,796,927	3,708,463	0	0	0
Michigan	24,990,925	36,951,985	30,177,398	6,774,587	36,951,985	30,177,398	6,774,587	0	0	0
Minnesota	5,028,690	3,656,452	2,413,771	1,242,681	3,645,297	2,413,771	1,231,526	11,155	0	11,155
Mississippi	1,883,590	774,195	339,046	435,149	774,195	339,046	435,149	0	0	0
Missouri	4,368,504	2,301,689	893,974	1,407,715	1,697,932	742,646	955,287	603,757	151,329	452,428
Montana	229,686	41,343	41,343	0	41,343	41,343	0	0	0	0
Nebraska	2,029,841	1,729,346	1,145,609	583,737	1,638,678	1,145,609	493,069	90,668	0	90,668
Nevada	2,465,943	1,463,016	863,080	599,936	1,428,145	863,080	565,065	34,871	0	34,871
New Hampshire	1,087,336	565,415	565,415	0	565,415	565,415	0	0	0	0
New Jersey	21,973,246	39,195,163	32,959,869	6,235,294	39,195,163	32,959,869	6,235,294	0	0	0
New Mexico	1,205,082	573,163	253,067	320,096	510,542	253,067	257,475	62,621	0	62,621
New York	61,004,816	150,070,294	103,708,187	46,362,107	115,607,390	91,507,224	24,100,166	34,462,904	12,200,963	22,261,941
North Carolina	3,461,763	1,040,669	173,088	867,581	820,812	173,088	647,724	219,857	0	219,857
North Dakota	637,943	434,677	280,695	153,982	414,033	280,695	133,338	20,643	0	20,643
Ohio	16,325,970	13,278,540	9,051,865	4,226,675	12,541,463	8,979,284	3,562,179	737,077	72,581	664,496
Oklahoma	2,942,200	1,920,132	676,706	1,243,427	1,422,437	676,706	745,731	497,695	0	497,695
Oregon	5,488,418	5,915,462	5,915,462	0	5,915,462	5,915,462	0	0	0	0
Pennsylvania	25,123,368	30,907,214	24,456,479	6,448,735	30,761,344	24,456,479	6,302,865	145,870	0	145,870
Rhode Island	2,769,804	4,480,365	3,648,222	832,144	4,480,365	3,648,222	832,144	0	0	0
South Carolina	1,701,560	423,420	119,109	304,311	411,591	119,109	292,482	11,829	0	11,829
South Dakota	654,962	412,622	253,820	158,802	377,347	253,820	123,527	35,275	0	35,275
Tennessee	5,049,571	2,976,436	996,551	1,981,885	2,542,000	996,356	1,545,643	436,437	195	436,242
Texas	21,464,143	15,921,037	8,800,299	7,120,739	14,551,479	8,800,299	5,751,181	1,369,558	0	1,369,558
Utah	1,752,599	1,722,316	1,218,057	504,259	1,607,819	1,218,057	389,762	114,497	0	114,497
Vermont	1,086,943	1,248,044	1,010,857	237,187	1,248,044	1,010,857	237,187	0	0	0
Virginia	2,442,002	650,831	190,363	460,468	415,186	61,050	354,136	235,645	129,313	106,333
Washington	15,808,199	28,374,120	22,526,684	5,847,436	27,600,627	22,526,684	5,073,943	773,493	0	773,493
West Virginia	1,482,576	634,641	346,192	288,449	634,641	346,192	288,449	0	0	0
Wisconsin	8,768,460	8,820,749	6,751,714	2,069,035	8,715,211	6,751,714	1,963,497	105,539	0	105,539
Wyoming	228,375	75,926	27,405	48,521	65,971	27,405	38,566	9,955	0	9,955
District of Columbia	920,707	978,912	758,259	220,653	-	-	-	978,912	758,259	220,653

Notes: 2003 state fiscal years run from July 1, 2002 to June 30, 2003. General sales taxes do not apply to cigarettes in Colorado. In Alabama, Georgia and Missouri the sales tax base does not include the cigarette excise.

Table 2

Internet Cigarette Sales and Resulting State & Local Government Cigarette Excise and Sales Tax Revenue Losses by State
FY 2005, Assuming Internet Sales Account for 6 Percent of the Total Consumption

	Internet Cigarette Sales (Packs of 20)	State & Local Government Revenue Losses: State & Local			State			Local		
		Total	Excise	Sales	Total	Excise	Sales	Total	Excise	Sales
United States	1,203,714,856	$1,695,700,300	$1,190,912,060	$504,788,240	$1,527,858,961	$1,147,078,298	$380,780,663	$167,841,339	$43,833,762	$124,007,577
Alabama	10,872,371	7,988,130	2,452,329	5,535,801	5,078,503	1,793,941	3,284,562	2,909,626	658,388	2,251,239
Alaska	3,315,246	3,792,017	3,792,017	0	3,315,246	3,315,246	0	476,772	476,772	0
Arizona	31,004,992	52,141,626	36,585,891	15,555,736	48,229,363	36,585,891	11,643,473	3,912,263	0	3,912,263
Arkansas	7,920,180	5,401,894	2,494,857	2,907,038	4,750,810	2,494,857	2,255,953	651,084	0	651,084
California	139,752,609	190,370,898	121,584,770	68,786,128	174,592,623	121,584,770	53,007,854	15,778,274	0	15,778,274
Colorado	3,620,351	724,070	724,070	0	724,070	724,070	0	0	0	0
Connecticut	23,991,196	43,255,415	36,226,709	7,028,707	43,255,415	36,226,709	7,028,707	0	0	0
Delaware	891,388	213,933	213,933	0	213,933	213,933	0	0	0	0
Florida	42,619,861	26,035,243	14,448,133	11,587,110	25,628,640	14,448,133	11,180,507	406,603	0	406,603
Georgia	14,597,048	8,200,039	1,751,646	6,448,394	5,716,064	1,751,646	3,964,418	2,483,976	0	2,483,976
Hawaii	7,418,833	11,970,167	10,386,366	1,583,801	11,970,167	10,386,366	1,583,801	0	0	0
Idaho	2,433,592	1,115,055	681,406	433,649	1,115,055	681,406	433,649	0	0	0
Illinois	73,109,842	103,810,528	76,663,105	27,157,423	95,510,938	71,647,645	23,863,292	8,299,591	5,005,460	3,294,131
Indiana	24,837,534	20,071,595	13,784,832	6,286,763	20,071,595	13,784,832	6,286,763	0	0	0
Iowa	7,115,900	4,192,855	2,561,724	1,631,231	4,046,273	2,561,724	1,484,549	146,582	0	146,582
Kansas	11,352,409	12,798,042	8,968,403	3,829,638	11,984,043	8,968,403	3,015,640	813,998	0	813,998
Kentucky	6,182,133	1,636,929	185,464	1,451,465	1,636,852	185,464	1,451,388	76	0	76
Louisiana	13,202,414	13,385,269	4,752,869	8,632,400	8,866,709	4,752,869	4,113,840	4,518,560	0	4,518,560
Maine	7,430,906	9,470,219	7,430,906	2,039,313	9,470,219	7,430,906	2,039,313	0	0	0
Maryland	26,040,510	32,740,996	26,040,510	6,700,486	32,740,996	26,040,510	6,700,486	0	0	0
Massachusetts	42,210,435	75,648,316	63,737,756	11,910,560	75,648,316	63,737,756	11,910,560	0	0	0
Michigan	70,779,695	110,422,420	88,474,619	21,947,801	110,422,420	88,474,619	21,947,801	0	0	0
Minnesota	14,445,622	11,062,240	6,933,899	4,128,341	11,025,182	6,933,899	4,091,283	37,058	0	37,058
Mississippi	5,557,345	2,466,933	1,000,322	1,466,611	2,466,933	1,000,322	1,466,611	0	0	0
Missouri	12,972,313	7,565,105	2,654,665	4,910,439	5,537,557	2,205,293	3,332,264	2,027,547	449,372	1,578,175
Montana	639,962	115,193	115,193	0	115,193	115,193	0	0	0	0
Nebraska	4,690,130	3,433,151	1,953,150	1,480,001	3,203,273	1,953,150	1,250,123	229,878	0	229,878
Nevada	6,941,030	4,224,496	2,429,361	1,795,136	4,120,156	2,429,361	1,690,796	104,340	0	104,340
New Hampshire	2,963,998	1,541,279	1,541,279	0	1,541,279	1,541,279	0	0	0	0
New Jersey	60,257,487	109,357,814	90,386,230	18,971,584	109,357,814	90,386,230	18,971,584	0	0	0
New Mexico	9,551,427	12,132,906	8,691,799	3,441,107	11,459,717	8,691,799	2,767,918	673,189	0	673,189
New York	168,252,494	434,952,127	286,029,240	148,922,887	329,792,528	252,378,741	77,413,787	105,159,599	33,650,499	71,509,100
North Carolina	10,509,644	3,519,289	525,482	2,993,807	2,760,617	525,482	2,235,135	758,672	0	758,672
North Dakota	1,841,360	1,320,017	810,198	509,819	1,251,669	810,198	441,471	68,348	0	68,348
Ohio	46,043,279	39,419,323	25,528,500	13,890,823	37,030,784	25,323,804	11,706,980	2,388,540	204,697	2,183,843
Oklahoma	8,720,658	6,281,578	2,005,751	4,275,826	4,570,131	2,005,751	2,564,380	1,711,446	0	1,711,446
Oregon	17,970,458	23,002,187	23,002,187	0	23,002,187	23,002,187	0	0	0	0
Pennsylvania	70,859,496	91,443,863	70,859,496	20,584,367	90,978,247	70,859,496	20,118,751	465,616	0	465,616
Rhode Island	8,877,142	17,274,692	14,203,427	3,071,264	17,274,692	14,203,427	3,071,264	0	0	0
South Carolina	5,290,518	1,500,512	370,336	1,130,176	1,456,580	370,336	1,086,244	43,933	0	43,933
South Dakota	2,399,541	2,001,309	1,271,757	729,552	1,839,251	1,271,757	567,494	162,058	0	162,058
Tennessee	15,526,474	10,315,468	3,105,894	7,209,574	8,727,936	3,105,295	5,622,641	1,587,532	599	1,586,933
Texas	61,579,533	48,226,377	25,247,609	22,978,768	43,806,785	25,247,609	18,559,176	4,419,592	0	4,419,592
Utah	4,977,838	4,982,691	3,459,598	1,523,094	4,636,857	3,459,598	1,177,259	345,835	0	345,835
Vermont	3,775,371	5,508,368	4,492,692	1,015,676	5,508,368	4,492,692	1,015,676	0	0	0
Virginia	7,385,879	2,207,061	575,756	1,631,305	1,439,246	184,647	1,254,599	767,814	391,109	376,706
Washington	43,792,745	78,828,764	62,404,662	16,424,102	76,656,201	62,404,662	14,251,539	2,172,563	0	2,172,563
West Virginia	7,437,370	5,918,382	4,090,553	1,827,828	5,918,382	4,090,553	1,827,828	0	0	0
Wisconsin	24,930,516	26,249,995	19,196,497	7,053,498	25,890,206	19,196,497	6,693,709	359,789	0	359,789
Wyoming	1,828,907	1,607,641	1,097,344	510,296	1,502,941	1,097,344	405,596	104,700	0	104,700
District of Columbia	2,996,867	3,855,785	2,996,867	858,917	-	-	-	3,855,785	2,996,867	858,917

Notes: 2005 state fiscal years run from July 1, 2004 to June 30, 2005. General sales taxes do not apply to cigarettes in Colorado. In Alabama, Georgia and Missouri the sales tax base does not include the cigarette excise.

Table 3

Internet Cigarette Sales and Resulting State & Local Government Cigarette Excise and Sales Tax Revenue Losses by State
FY 2005, Assuming Internet Sales Account for 14 Percent of the Total Consumption

	Internet Cigarette Sales (Packs of 20)	State & Local Government Revenue Losses State & Local			State			Local		
		Total	Excise	Sales	Total	Excise	Sales	Total	Excise	Sales
United States	2,808,667,997	$3,956,634,034	$2,778,794,806	$1,177,839,228	$3,565,004,243	$2,676,516,029	$888,488,214	$391,629,791	$102,278,778	$289,351,014
Alabama	25,368,866	18,638,969	5,722,100	12,916,868	11,849,841	4,185,863	7,663,978	6,789,128	1,536,238	5,252,891
Alaska	7,735,573	8,848,041	8,848,041	0	7,735,573	7,735,573	0	1,112,467	1,112,467	0
Arizona	72,344,982	121,663,794	85,367,078	36,296,716	112,535,181	85,367,078	27,168,103	9,128,613	0	9,128,613
Arkansas	18,480,420	12,604,420	5,821,332	6,783,088	11,085,223	5,821,332	5,263,891	1,519,197	0	1,519,197
California	326,089,421	444,198,761	283,697,796	160,500,965	407,382,788	283,697,796	123,684,992	36,815,973	0	36,815,973
Colorado	8,447,487	1,689,497	1,689,497	0	1,689,497	1,689,497	0	0	0	0
Connecticut	55,979,462	100,929,302	84,528,987	16,400,315	100,929,302	84,528,987	16,400,315	0	0	0
Delaware	2,079,906	499,178	499,178	0	499,178	499,178	0	0	0	0
Florida	99,446,343	60,748,901	33,712,310	27,036,591	59,800,161	33,712,310	26,087,850	948,740	0	948,740
Georgia	34,059,779	19,133,425	4,087,174	15,046,252	13,337,482	4,087,174	9,250,308	5,795,943	0	5,795,943
Hawaii	17,310,610	27,930,389	24,234,854	3,695,535	27,930,389	24,234,854	3,695,535	0	0	0
Idaho	5,578,382	2,601,796	1,589,947	1,011,848	2,601,796	1,589,947	1,011,848	0	0	0
Illinois	170,589,632	242,224,566	178,857,245	63,367,321	222,858,855	167,177,839	55,681,016	19,365,712	11,679,406	7,686,305
Indiana	57,954,247	46,833,721	32,164,607	14,669,114	46,833,721	32,164,607	14,669,114	0	0	0
Iowa	16,603,767	9,783,562	5,977,356	3,806,206	9,441,304	5,977,356	3,463,948	342,258	0	342,258
Kansas	26,488,955	29,862,097	20,926,275	8,935,822	27,962,768	20,926,275	7,036,493	1,899,329	0	1,899,329
Kentucky	14,424,977	3,819,500	432,749	3,386,751	3,819,322	432,749	3,386,573	178	0	178
Louisiana	30,805,632	31,232,295	11,090,028	20,142,267	20,688,987	11,090,028	9,598,960	10,543,307	0	10,543,307
Maine	17,338,781	22,097,177	17,338,781	4,758,397	22,097,177	17,338,781	4,758,397	0	0	0
Maryland	60,761,189	76,395,657	60,761,189	15,634,468	76,395,657	60,761,189	15,634,468	0	0	0
Massachusetts	98,491,014	176,512,738	148,721,431	27,791,307	176,512,738	148,721,431	27,791,307	0	0	0
Michigan	165,152,622	257,652,313	206,440,778	51,211,535	257,652,313	206,440,778	51,211,535	0	0	0
Minnesota	33,706,451	25,811,893	16,179,097	9,632,797	25,725,424	16,179,097	9,546,328	86,469	0	86,469
Mississippi	12,967,138	5,756,177	2,334,085	3,422,092	5,756,177	2,334,085	3,422,092	0	0	0
Missouri	30,268,730	17,651,911	6,194,219	11,457,691	12,920,967	5,145,684	7,775,283	4,730,944	1,048,535	3,682,408
Montana	1,493,245	268,784	268,784	0	268,784	268,784	0	0	0	0
Nebraska	10,943,637	8,010,686	4,557,350	3,453,335	7,474,304	4,557,350	2,916,954	536,382	0	536,382
Nevada	16,195,737	9,857,158	5,668,508	4,188,650	9,613,698	5,668,508	3,945,190	243,460	0	243,460
New Hampshire	6,915,996	3,596,318	3,596,318	0	3,596,318	3,596,318	0	0	0	0
New Jersey	140,600,803	255,168,233	210,901,204	44,267,029	255,168,233	210,901,204	44,267,029	0	0	0
New Mexico	22,286,664	28,310,113	20,280,864	8,029,250	26,739,339	20,280,864	6,458,475	1,570,774	0	1,570,774
New York	392,589,183	1,014,888,295	667,401,560	347,486,736	769,515,899	588,883,729	180,632,170	245,372,397	78,517,831	166,854,566
North Carolina	24,522,502	8,211,674	1,226,125	6,985,549	6,441,440	1,226,125	5,215,315	1,770,234	0	1,770,234
North Dakota	4,296,506	3,080,040	1,890,463	1,189,577	2,920,561	1,890,463	1,030,098	159,479	0	159,479
Ohio	107,434,319	91,978,421	59,566,501	32,411,920	86,405,162	59,088,875	27,316,287	5,573,259	477,626	5,095,633
Oklahoma	20,348,203	14,657,014	4,680,087	9,976,928	10,663,639	4,680,087	5,983,553	3,993,375	0	3,993,375
Oregon	41,931,069	53,671,769	53,671,769	0	53,671,769	53,671,769	0	0	0	0
Pennsylvania	165,338,825	213,369,014	165,338,825	48,030,189	212,282,577	165,338,825	46,943,752	1,086,437	0	1,086,437
Rhode Island	20,713,331	40,307,614	33,141,330	7,166,283	40,307,614	33,141,330	7,166,283	0	0	0
South Carolina	12,344,541	3,501,196	864,118	2,637,078	3,398,686	864,118	2,534,568	102,509	0	102,509
South Dakota	5,598,930	4,669,721	2,967,433	1,702,289	4,291,585	2,967,433	1,324,152	378,136	0	378,136
Tennessee	36,228,439	24,069,425	7,247,086	16,822,339	20,365,184	7,245,688	13,119,496	3,704,241	1,398	3,702,843
Texas	143,685,577	112,528,213	58,911,087	53,617,126	102,215,831	58,911,087	43,304,745	10,312,382	0	10,312,382
Utah	11,614,956	11,626,280	8,072,395	3,553,885	10,819,332	8,072,395	2,746,937	806,948	0	806,948
Vermont	8,809,199	12,852,858	10,482,947	2,369,910	12,852,858	10,482,947	2,369,910	0	0	0
Virginia	17,233,718	5,149,808	1,343,430	3,806,379	3,358,241	430,843	2,927,398	1,791,567	912,587	878,980
Washington	102,183,073	183,933,782	145,610,879	38,322,904	178,864,469	145,610,879	33,253,590	5,069,314	0	5,069,314
West Virginia	17,353,863	13,809,558	9,544,625	4,264,933	13,809,558	9,544,625	4,264,933	0	0	0
Wisconsin	58,171,204	61,249,968	44,791,827	16,458,161	60,410,461	44,791,827	15,618,633	839,507	0	839,507
Wyoming	4,267,450	3,751,161	2,560,470	1,190,692	3,506,661	2,560,470	946,392	244,300	0	244,300
District of Columbia	6,992,690	8,996,831	6,992,690	2,004,141	-	-	-	8,996,831	6,992,690	2,004,141

Notes: 2005 state fiscal years run from July 1, 2004 to June 30, 2005. General sales taxes do not apply to cigarettes in Colorado. In Alabama, Georgia and Missouri the sales tax base does not include the cigarette excise.

Mr. GREEN. Thank you for your testimony. I thank again all the witnesses for testifying. I will begin with questions.

Mr. Jones, in your research you came across a large number of Web sites that sell so-called tax free cigarettes. Did your research show who the operators of those Web sites are?

Mr. JONES. For the most part it had indications of the owners. We identified, as I say, 147 sites. The majority of those sites were Native American sites, 87 out of the 147 were Native Americans. Some of the others listed addresses and names. It was for the most part Native Americans, 87 out of 147.

Mr. GREEN. Okay. Thank you. And if you will take a look, I hope you have had a chance, as all the witnesses I know have had a chance, to take a look at this color handout that we have given here which shows just some of the Web sites that are there. Mr. Jones, can you tell me as you look at those, was that sort of characteristic of the Web sites that you researched?

Mr. JONES. Yes. We searched terms such as cheap cigarettes, free taxes, and so forth. And we also came up with a set of Internet sites similar to the ones shown here. I think the interesting thing is that when you search on these sites it becomes very obvious that the selling point is the lack of taxes and that is what draws the seller to those sites. I think, too, that in some cases that the site also will lure you on with buying one cigarette and then talk you into buying one that they can make more money on such as a generic brand versus premium brand. We found some of those cases also.

While we didn't specifically look at this in terms of the issue of youth smoking, our review didn't specifically look at that issue, but looking at some of the sites in terms of how you would order cigarettes there were some indications that youth could buy cigarettes with very little identification. Although they asked for verification of age it would just require certification in the statement that I am of age. And of course if you want to buy a cigarette, you certify.

Mr. GREEN. Every high school student's dream.

Mr. JONES. My son had an ID card that had a false age, too. So I think it is very easy if a youth wanted to falsify his age via the Internet because as I said in my statement the Internet is anonymous, you can use the Internet without being physically there. So to an extent it is anonymous, it also makes it very easy for people who might be ashamed to go to stores to buy cigarettes because of the social issues, they also find its another avenue to procure cigarettes over the Internet.

Mr. GREEN. Interesting. Mr. Armour, could you comment on or expound upon the threat that these remote sellers present to brick and mortar stores?

Mr. ARMOUR. I think the largest one, going back to what I said in my testimony, you look at Washington State. By not collecting State excise and sales taxes it is $20 a carton. That is an enormous price advantage. And while in Washington State I can't quantify the instances of Internet or mail order sales into the State because we have so many Indian reservations in urban areas that already are siphoning off a great deal of excise taxes, our State Department of Revenue estimated 3 years ago that the loss of State excise taxes

in Washington State due to Indian reservation sales exceeded $130 million a year.

So I think that is indicative of the wide discrepancy in prices that retailers that don't collect taxes have.

Mr. GREEN. Interesting.

Mr. Myers, what do you think is the best way that Internet sales can verify age, Internet sellers can verify age? Do you have any suggestions on how that might be accomplished?

Mr. MYERS. We do. And Congressman Meehan's bill that he introduced previously represents our thinking as well on that. What you need to do is require a Government database checked photo ID both at the time of the initial transaction over the Internet and then second at the point of delivery. If you don't do both, then you have opened up a path either way. If you do do both, then you can get a real clamp on these issues.

We would be happy to work on the specific detailed provisions about how to do that. But I think it is essential if we are going to really put a clamp on illegal sales to children all across the country.

Mr. GREEN. Thank you. Now the Chair recognizes Mr. Meehan for his questions.

Mr. MEEHAN. Thank you, Mr. Chairman. Mr. Jones, thank you for appearing at this hearing and also for an excellent GAO report that both Congressman Conyers and I had requested. I may be going over some of your testimony you have already presented, but I want to make the Subcommittee record clear on some points.

Mr. Jones, both the Department of Justice and the Bureau of Alcohol, Tobacco and Firearms commented on your draft report, is that correct?

Mr. JONES. That is correct.

Mr. MEEHAN. What did the Department of Justice state in regards to the fact that the Jenkins Act only contained misdemeanor penalties in terms of the U.S. attorney's willingness to prosecute cases?

Mr. JONES. Both the Justice Department and the Treasury Department commented on the draft report, suggested that felony as a penalty would increased compliance with the Jenkins Act. They also made some other suggestions in terms of getting more enforcement by States, allowing States more authority to take Jenkins Act enforcement to State courts and Federal district courts. The concern with the——

Mr. MEEHAN. So that was the input that you got from the Justice Department?

Mr. JONES. Yes. The concern was that by making it a felony you would get more U.S. attorneys to take the cases to Federal court. As you know, U.S. attorneys have a limited staff and they can't take every Federal case to Federal court. They have a certain—I guess it is pretty well known they have thresholds that they use to take cases to Federal court, and they very rarely take misdemeanors to a Federal court. And because these are misdemeanors, very little attention is given to these cases because Federal law enforcement knows that they won't be able to get U.S. attorneys to take these cases to Federal court.

So I think the reason that the Federal Government doesn't enforce the law; that is, the FBI and the ATF, is because they can't get U.S. attorneys to take the cases to court.

Mr. MEEHAN. It is your testimony as well, you mention the Treasury Department, the ATF, the agency that you recommend to have jurisdiction over this matter, that now potentially we could accomplish administratively. They made the same representations in the comments?

Mr. JONES. Yes. And they went—ATF when a step further and offered to take over the responsibility of enforcement. As you know, ATF now enforces the Cigarette Contraband Trafficking Act, which is a smuggling act, and it also carries a felony penalty. So they feel by having the comprehensive authority to enforce the Jenkins Act and CTA act that they will have the whole issue in one court. And since ATF has been transferred now from Treasury to the Justice Department, we think that Justice can handle that issue and Congress doesn't need to worry about that right now.

Mr. MEEHAN. Excellent.

Mr. Myers, your testimony mentioned the growing problem of kids buying cigarettes over the Internet in the absence of safeguards to prevent these types of sales. Massachusetts Attorney General Tom Reilly and I actually conducted our own sting operation on two separate occasions and we were astounded at how easily it was for young children who participated in the sting, how easy it was for them to buy cigarettes over the Internet with the click of the mouse.

Do you think this new legislation addresses the growing problem with youth access to tobacco over the Internet, and how specifically can we better address this problem that I think it is clear that we all agree it is, certainly Congressman Green and I are in strong agreement on?

Mr. MYERS. It is a vitally important problem. And State attorney generals have done more to stop illegal sales at the brick and mortar retailers. Then it becomes even more important to address the issue here. There are a number of things we have to do. First, strong enforcement of tax evasion is a component of the issue. If the cigarettes aren't cheaper kids will be less likely to buy them. But, second, we have to have a meaningful set of provisions for age verification, as Congressman Green and I discussed earlier. We need to make sure it hits both at the point of sale and at the point of delivery. We need to hold the people in that line of process accountable for it. That includes adequate record keeping. So this bill by itself does not solve that problem.

Mr. MEEHAN. Will giving States attorneys general the right to bring a case to Federal court help reduce the problem with youth access?

Mr. MYERS. Giving State attorneys general the right to sue along with the tools they need to do so will make a difference. This bill needs to be beefed up to accomplish it. Unless it is clear that it is the out-of-state sellers who have the obligation to collect and pay the tax, unless the State attorneys general have the authority to actually block sales by a seller who is not living up to the law and to ban future sales, and unless you have penalties that include fel-

ony penalties, then you will not accomplish the goal that I think we all agree upon.

Mr. MEEHAN. Thank you.

Mr. GREEN. I thank the gentleman. The Chair recognize Mr. Keller, the gentleman from Florida.

Mr. KELLER. Thank you very much, Mr. Green. Mr. Myers, let me begin with you. And I want to thank you so much for coming before our Committee today and taking time to educate us on your issues. I know all of us share your concern about underage children smoking. Let me just tell you one thing in the interest of States, if I had somebody from the National Center for Tougher Sentences for Child Abusers here before us and we had a bill to make dramatically tougher sentences for child abusers and they were saying they weren't supportive of it, I would think to myself what in the hell are these people thinking. I would think that they would be almost marginalizing themselves by saying we are not going to support it unless you make different changes that we uniquely would do.

So my question is now, faced with the situation where we have a very real problem with underage children smoking because these remote Web sites are failing to do adequate age verifications and they are making it easier and cheaper for kids to buy cigarettes and this bill would in fact ensure that the age verification and tax collection would take place for remote sales of cigarettes at least better than it is now, why are you not supporting this legislation as written?

Mr. MYERS. I am glad you asked that question. Because the answer is straightforward. The Jenkins Act was passed with the best of intentions and failed because it didn't have adequate teeth. It doesn't have adequate enforcement provisions. Our goal, like yours, is to come up with a piece of legislation that will actually make a difference. We don't move our ball forward if we don't give the State attorneys general the actual tools they need. Based on a lot of conversations with a lot of law enforcement officials, it has been our conclusion that without making the changes we suggest, none of which are radical, none of which are extraordinary, that you won't in fact make the difference that both you and I want to see made.

This isn't a matter of the perfect being the enemy of the good. It is a matter of making sure that you pass a piece of legislation that will actually do what you and I want. As drafted, we have been told by lots of people this bill won't get us there. I am convinced that working with Congressman Green and Congressman Meehan we can get there with a reasonable bill.

Mr. KELLER. Thank you for that. That is fair. I want to give you your side of that. I would encourage reasonableness on both sides.

Mr. MYERS. That is why one of the things we first did was in fact go out to the people who have to enforce the law and ask them about the adequacy of these provisions. Will it make a real difference because I know that is what you want? What we were told is that unless you take a number of the steps that we have described here, that all we are doing is kidding ourselves and no one here intends to do that.

Mr. KELLER. Mr. Jones, turning to you, does Native American status as far as you know serve as a valid defense for noncompliance with State laws regulating the sale and distribution or possession of cigarettes? In other words, can an Indian tribe by virtue of their own sovereignty say if I want to sell to a 12-year-old I can sell to a 12-year-old; is that legal on their part?

Mr. JONES. Our legal staff has found that is not true, that Native Americans do not have automatic exemption from the Jenkins Act. In fact, a search of the Jenkins Act itself and its legislative history does not provide an exemption to Native American sales of cigarettes.

Mr. KELLER. It hasn't been raised in this hearing but I read some people may take the opinion that the Internet Tax Freedom Act provides some sort of legitimate basis for noncompliance with the Jenkins Act or State laws relating to the sale of cigarettes. Do you have a thought on that?

Mr. JONES. Yes. The Internet Tax Freedom Act was designed to exempt new businesses from adding tax for operating over the Internet. It did not exempt taxes that are already in effect. So the Internet Tax Freedom Act was to prohibit taxes on new products or new uses of the Internet, not for current.

Mr. KELLER. It is a separate issue. What procedures do remote sellers now employ, if any, to ensure compliance with the Federal and State laws restricting cigarettes to underage minors?

Mr. JONES. We found that some, as I said earlier, do have a certification statement that the buyer has to certify that he is of age to buy cigarettes. But that is a matter of just a certification. And the certification is worth as much as signing the note. Some also post you must be of age to purchase cigarettes but they don't necessarily enforce those ads.

Mr. KELLER. So some of them ask you how old you are and some don't?

Mr. JONES. That is true.

Mr. KELLER. Okay. Mr. Chairman, I will yield back the balance of my time.

Mr. SMITH. [Presiding.] Thank you, Mr. Keller. Let me apologize to the witnesses. I had a vote come up in another Committee. It was a close vote and I needed to excuse myself. Mr. Myers, I am sorry that was in the middle of your testimony, but I hope to catch up with you all now.

The gentleman from Virginia, Mr. Boucher, is recognized for his questions.

Mr. BOUCHER. Thank you very much, Mr. Chairman. I want to begin by commending our colleague Mr. Green for bringing this matter before the Committee. I am sorry he is not here to hear me say that.

Mr. SMITH. He had to be on the House floor to speak on the rule.

Mr. BOUCHER. That is an understandable need. So I do want to commend him for bringing this matter before the Committee. I find myself in basic agreement with his approach that the sales and use taxes of the State of residence of the purchaser should be honored with respect to interstate transactions in cigarettes. But I note that the bill really is limited just to cigarettes. Of course we know that there are other tobacco products.

I would like to ask you, Mr. Jones, and you, Mr. Fleenor, if in the course of your research with respect to the volume of interstate sales of cigarettes you encountered data that would reveal to you a comparison in terms of volume of cigarette sales on the one hand and sales of other tobacco products, smokeless and cigars and other kinds of things, on the other hand.

Give us a sense, if you have this information, of the volume of cigarette sales on an interstate basis as compared to sales of these other products.

Mr. FLEENOR. Well, I looked at it a bit, and the sales of smokeless tobacco, chew, snuff, et cetera are relatively small in comparison to cigarettes, about probably—only about four or 5 percent of—in terms of revenue that—I guess compared to cigarettes.

Mr. BOUCHER. Of the total sales, cigarettes would be 96 percent, and other products would be about 4 percent?

Mr. FLEENOR. Exactly.

Mr. BOUCHER. Mr. Jones, have you looked at that issue and do you agree with those numbers?

Mr. JONES. Our review didn't focus on that but we did notice a majority of the sales were cigarettes.

Mr. BOUCHER. I am sure that is true. Does anyone on the program have a comment with respect to why this bill should be limited just to cigarettes? I know Mr. Myers has advocated that the other products be included. Does anyone have a view that is contrary to that of Mr. Myers, or would anyone like to defend the position of the bill that basically limits its application just to cigarette sales? Let the record show there was silence.

Let me ask another question. Some have suggested that this——

Mr. ARMOUR. Just on that, a thought I have is, in many States, cigarettes are tax stamped. Like in Washington State, the cigarettes are tax stamped. So it is very easy for the Liquor Control Board, who has enforcement, to identify that this is a contraband product in our State by looking at it. None of the other tobacco products in our State are required to be tax stamped. So there may be some kind of enforcement issue related——

Mr. BOUCHER. With respect to cigarettes. Well, I think the Committee will need to consider this question as we give further consideration to the bill.

Mr. Myers, you noted in your testimony, and perhaps in answering one or more of the questions, that you questioned the effectiveness of the provision which is found on Page 2 beginning at Line 9 of the bill, that basically says that the sales and use taxes of the State of the residence of the purchaser would have to be honored in the case of interstate transactions.

This language looks pretty straightforward to me. I am wondering what weakness you see in it, and why you think the language, as it appears in the bill itself, is not effective in terms of making sure that the residence—that the taxes of the State of the residence of the purchaser be paid.

Mr. MYERS. Let me answer that for you in two ways.

First, is what we have done is look at some of the State laws, and some of them are very unclear as to their applicability to out-of-State sellers. In fact, some of them, because the States didn't think they had the authority here, say that—actually provide an

option, for either the out-of-State seller to pay or for the purchaser to pay, and simply applying those laws that were passed in a different circumstance could lead to a situation where it is the purchaser, not the seller, who is responsible. I don't think that is the intention, which is why it has been our view that we ought to be explicit about that.

Mr. BOUCHER. I am sorry. Let me just ask you.

This clearly says, each person who engages in the interstate, sale or distribution. Now, that clearly would be the seller. This is the person engaging in the interstate sale or distribution, or at a minimum it is the seller. You might also suggest that it is the purchaser, but it is clearly at least the seller, shall comply with all of the sales and use tax and other laws of the State in which the cigarettes are delivered. I don't see how that——

Mr. MYERS. Those laws don't apply, A, either to a retailer—and often it is the wholesaler distributor further up the line who does it in a normal in-state situation, and that wouldn't be the case for the out of State seller, and it certainly would be the case for an Indian reservation or outside our borders—then you would have an open and ambiguous question. Some of those people have been challenged before and said those laws don't apply to them.

Second, the question I would pose back, since I think everyone's intention is the same here, and that is to have those sellers pay, and I think that is your intention as well. Then there is really no down side to being explicit about it, so that we don't force the State Attorney Generals to have to go through 5, 10 years of litigation based on the vagaries of State laws that were written for a different purpose. It is an easy enough thing to insert, eliminate the ambiguity and then allow the State Attorney Generals to have the tool to begin to enforce it right away.

Mr. BOUCHER. Okay. Mr. Myers, thank you very much.

Thank you, Mr. Chairman. My time is up.

Mr. SMITH. Thank you, Mr. Boucher. The gentleman from Indiana, Mr. Pence is recognized for his questions.

Mr. PENCE. Thank you, Mr. Chairman.

And I want to associate myself with comments on both sides today, expressing appreciation for Mr. Green's leadership on this legislation. I also want to associate myself a bit with Mr. Keller's comments concerning a bit of befuddlement about opposition from an organization dedicated to protecting children from tobacco, finding itself as an opponent of legislation that would make laws tougher, and I do—I don't necessarily come to these hearings to put witnesses on the spot, unless I am in an especially bad mood. So I will accept, Mr. Myers, your comments and your testimony and your responses to Mr. Keller about the sincerity of your purpose in coming here and wanting to improve a piece of legislation, because when I heard of the National Center for Tobacco-Free Kids' opposition to Mr. Green's legislation, I was confused. You have abated that a bit, but——

Mr. MYERS. Congressman, could I just respond briefly?

Mr. PENCE. I would welcome that.

Mr. MYERS. We know we always take a risk when we take a piece of legislation that is well-intended, whose goals we both share, and then say it doesn't simply give enough tools to actually

accomplish its goal. That decision was not taken lightly. It was based upon multiple conversations, frankly over several years, where we have been working with State officials about the kinds of tools they need to really make a difference. And we have just been told by too many law enforcement officials, that if you are going to give us this responsibility, you have got to give us the tools. Otherwise, we may file a lawsuit, but given the hundreds and hundreds of Internet sellers out there, the fly-by-night of them, the cost of enforcement is too great. We are not going to be able to do the job.

All we are trying to say is, if we really want to take this problem up and solve the problem that you and I agree on, then we need to do it. So our goal is very simple, and that is to make sure law enforcement officials have the tools to help reduce tobacco use.

Mr. PENCE. Reclaiming my time, then, I would like to then give Mr. Jones an opportunity to speak from a GAO perspective.

There has been an assertion on the panel today that essentially the Green legislation will not make a difference. Your report states that jurisdictions, particularly State jurisdictions, don't have sufficient legal authority today to enforce the Jenkins Act. Is it accurate to say that the Green legislation, as drafted, would help States better enforce the law, Mr. Jones?

Mr. JONES. Mr. Congressman, you are correct.

Our report does state that States had a problem because they lack enforcement authority in terms of the Jenkins Act, and I think that Congressman Green's bill does provide some support to States in terms of pursuing those violations of the Jenkins Act that they can take to court, either at a State level or in Federal district court. So it does provide some remedy for them.

Mr. PENCE. So it will improve the law?

Mr. JONES. It will improve States' involvement in enforcing the law.

Mr. PENCE. One question—pardon me, Mr. Jones.

Mr. JONES. As I understand. As I read the bill——

Mr. PENCE. Mr. Armour, I wanted to thank you for your testimony today. I grew up in the gas station business in southern Indiana. It is called convenience stores now, but we used to just sell food inside gas stations.

Your testimony indicated that your company particularly has instituted tobacco retailing practices to ensure that minors don't purchase tobacco products in your stores. How have your compliance rates with State laws changed since instituting these policies?

Mr. ARMOUR. We have always taken our responsibility seriously before there were the level of mandates today, but just to give you an order of magnitude, last year we—in our company we had over 2.6 million transactions that involved cigarettes. There were two Liquor Control Board sting operations in which sales associates of ours sold to minors, and there were two internal sting operations that we performed, as I said in my testimony, in which sales associates sold to minors. So four out of 2.6 million transactions, I think with appropriate steps and procedures that we have implemented have—that is not zero. I am not happy that four took place, but I think they can be very, very effective when implemented.

Mr. PENCE. Well, I thank you for your testimony, and as a parent, I thank you for your leadership.

As I do, Mr. Myers, and the leadership for the National Center for Tobacco-Free Kids. I place myself, Mr. Chairman, to be a constructive part of moving this legislation forward and yield back.

Mr. SMITH. Thank you, Mr. Pence.

The sometimes Ranking Member of the Subcommittee, Mr. Berman of California, is recognized for his questions. If he yields to the gentlelady from California, Ms. Waters for her questions, okay.

The gentlelady is recognized.

Ms. WATERS. Thank you very much, Mr. Chairman, and members.

It seems to me we have two distinct issues here. One that has to do with the sale of cigarettes to minors on the Internet and a failure to have any means by which to do age verification, and, of course, the tax issue with the concerns, I am sure raised by the brick and mortar retailers, and the fact that they have to pay their taxes and others don't.

It is very difficult for me to understand, as you deal with the Internet, how you single out any one product. It seems to me that just as many of us are concerned about sale to youth of cigarettes, aren't we concerned about the sale of youth—to youth of alcohol products and other kinds of things? Is this an isolated issue, or should we be looking at this issue in terms of all of those laws that may be violated relative to age verification, in particular maybe some other things. I don't know. I don't know if there is any effective way to do age verification. Maybe there is and I haven't heard it, and I will ask Mr. Myers or any of the other—who are present here today, is there—has anyone discovered any way to do age verification on the Internet?

Mr. MYERS. Well, the simplest way, of course, would be not to permit sale of tobacco products over the Internet, and, ultimately, that may be the best solution. We do think based upon examining this, talking with a number of responsible retailers and others, that by requiring the production of Government-issued Ids at the critical junctures, holding the people who deliver the product responsible, ensuring that it is only delivered to an adult, that you can do a number of steps that would dramatically cut down on youth sales under these circumstances.

We also think that if you have effective tools to make sure that State taxes are paid, you decrease the incentive. So there is much that we can do. Can we solve it fully without a total ban? Probably not, but there is much to be——

Ms. WATERS. You know, I am not an attorney, but it seems to me you could raise some equal protection questions about banning one particular item on the Internet and not others where age verification also is the law. How do you deal with that?

Mr. MYERS. There is more than a rational basis for addressing that issue. That is not before the Committee today, and Congressman Meehan's bill that seeks to both address youth access and tax evasion issues steps well short of a total ban and just ensures adequate age verification.

Congressman Meehan's bill might well be a good model for other products. I have no expertise in those, so I don't want to speak

about it, but there is something we can do about this product that would make a difference.

Mr. WATT. Mr. Myers, I am quite aware of what is before the Committee. I thought because you were here with your expertise, you may have given some creative thought to an issue that is so dear to you, but thank you for your response.

Mr. MYERS. Well, we have, and Congressman Meehan's original bill, that deals with both youth access and tax evasion issues is a solution that we think is both workable, complies with the law, and would make a real difference.

Mr. SMITH. The gentlewoman yields back her time. The gentleman from California, Mr. Berman, is recognized for his questions.

Mr. BERMAN. Thank you, Mr. Chairman, and I would like to yield my time to Mr. Meehan.

Mr. SMITH. Okay. The gentleman from Massachusetts is recognized.

Mr. MEEHAN. Thank you, Mr. Berman. I want to clear up one subject that my friend from Indiana had raised, and it is a question of what the language of the bill ought to be.

From my perspective, I have been working with my staff the last couple of days to try to have language that will effectively result in States' Attorney Generals being able to have not—as a practical matter being able to move against these companies on the Internet that don't pay State taxes and who sell to minors.

Specifically, yesterday I got on a plane after the last vote, and I went up and had dinner with the Attorney General of Massachusetts and the chief of his Public Protection Bureau, and I talked about language. I talked about the issue, because the Attorney General is nationally recognized for his efforts regarding cigarettes and tobacco products. And what he indicated to me was, if you just have civil penalties, it will make it more difficult. I discussed language with him.

So what we are trying to do here is actually pass a law that will have the intended effect, because oftentimes we pass legislation around here, and also in legislatures across the country that have unintended consequences. And it is not a reflection on how someone feels about who drafted a bill or how the bill was drafted, it simply has unintended consequences. It doesn't do what the legislation intended it to do or the authors of the legislation intended it to do. So what do you do? You talk to law enforcement officials that have the authority to actually enforce the law.

So I think that is what we are trying to do, get the best possible language, and I know Congressman Green is committed to doing that, because I have been working with him for the last few days.

Mr. Myers, do you think that this bill gives the States the incentive and support that they need to crack down on Internet tobacco sellers that violate State law restrictions on cigarette sales? And you have indicated specific language to get the—to make sure the AGs have the tools that they need to effectively crack down and prosecute these instances?

Mr. MYERS. Not as currently drafted. I don't think the bill will accomplish the goal that Congressman Meehan needs. The criminal penalties are not sufficient. They need to be made more severe. The

civil penalties need to be made clearer and more severe and include the right to block sellers who violate the law.

Third, it needs to be made clear that you can go against the seller, not just the consumer. Otherwise, you will never—the State Attorney Generals will never be able to get a grip on this problem or have the economic incentive to do so.

Mr. MEEHAN. The final point I wanted to make was relative to my friend from California's comments relative—why this product—this product is the leading preventable cause of death in the United States of America. It is the only product on the market if you use specifically as directed, it will kill you.

Two days ago, I had the unfortunate experience to be in a hospital in Hathorne, Massachusetts where my wife's aunt is dying and died at six o'clock this morning from lung cancer. She smoked for 40 years. She started smoking when she was 14. She had quit for the last 20 years or so, but the damage had already been done. Over 450,000 people die in this country each year because of tobacco use, and 90 percent of the people who smoke in America, start smoking when they are children. This is serious business. It affects the public health of this entire country.

So why this product? There are a lot of damn good reasons why this product. We need to make a commitment, and we are making a bipartisan commitment today, I believe, with this legislation to find a way to crack down on people that sell on the Internet and don't verify the ages and don't pay State taxes. And that is what we are about to do, and I hope that we are able to work out what I consider to be minor differences on language, and I know that Congressman Green is committed to this. But this is important work, and it is important work for the Congress.

Thank you, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Meehan, for a very good statement, and I hope, as you do, that you and Mr. Green will be able to resolve any differences and be able to produce a bill that we all can support. Clearly there was bipartisan—more than bipartisan. There was consensus this morning on the need for such legislation.

We had a lot of good questions and a lot of good answers today, and for that I thank the witnesses who are here. We may have some additional questions to submit to you in writing. We hope that you will be able to respond to those within 10 days, but thank you for being a part of a very important hearing and very constructive approach to trying to solve a very critical problem. With that, the Subcommittee is adjourned.

[Whereupon, at 11:20 a.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

May 5, 2003

Mr. Paul L. Jones
Director, Homeland Security and Justice
General Accounting Office
441 G Street, NW
Room 2A46
Washington, DC 20548

Dear Mr. Jones:

Thank you for appearing as a witness during our Subcommittee hearing on H.R. 1839. Representative Green has submitted written questions that he will appreciate having answered for the record. As a courtesy, I am forwarding his questions to you. Please respond in writing by close of business Tuesday, May 13.

Representative Green has two questions:

1. In your testimony, you noted the large number of internet sites selling tobacco that are owned by Native Americans. My understanding is that right now, regardless of the applicability of the Jenkins Act to Native Americans, the Act is not effectively enforced against them. According to a long line of decisions of the United States Supreme Court including *Santa Clara Pueblo v. Martinez*, 436 U.S. 49 (1978), *Oklahoma Tax Commission v. Potawatomi Indian Tribe*, 498 U.S. 505 (1991), and *Kiowa Tribe of Oklahoma v. Manufacturing Technologies*, 523 U.S. 751 (1998) it appears that Native American tribes are immune from lawsuits unless either the tribe or the U.S. Congress waive tribal sovereign immunity. Is it GAO's view that in order to allow states to enforce the Jenkins Act against Native American tribes through litigation, this legislation, H.R. 1839, must unequivocally include Native American tribes as among the parties that may be sued by the states?

2. Is it the case that legislation which does not unequivocally include Native American tribes as among the parties that can be sued to enforce its terms would run the risk of leaving the states without the ability to enforce the law against Native American tribes through litigation - even if the terms of the legislation did not include an exemption for Native Americans?

Paul Jones
May 5, 2003
PAGE TWO

Again, I would appreciate GAO's written response to these questions by close of business Tuesday, May 13. You may fax your answers to the attention of Eunice Goldring of the Subcommittee at 202-225-3673. If you have questions about this request please contact David Whitney at 202-225-5741.

Sincerely,

LAMAR SMITH
Chairman
Subcommittee on Courts, the Internet, and
Intellectual Property

LS/dw

cc: The Honorable Mark Green

United States General Accounting Office
Washington, DC 20548

May 23, 2003

The Honorable Lamar Smith
Chairman, Subcommittee on Courts,
the Internet, and Intellectual Property
Committee on the Judiciary
House of Representatives

Dear Mr. Chairman:

Following my May 1, 2003 testimony before your Subcommittee on H.R. 1839, Representative Green raised two questions, which you forwarded to me by letter dated May 5, 2003. Representative Green's questions and my response are as follows:

1. In your testimony, you noted the large numbers of Internet sites selling tobacco that are owned by Native Americans. My understanding is that right now, regardless of the applicability of the Jenkins Act to Native Americans, the Act is not effectively enforced against them. According to a long line of decisions of the United States Supreme Court including *Santa Clara Pueblo v. Martinez*, 436 U.S. 49 (1978), *Oklahoma Tax Commission v. Potawatomi Indian Tribe*, 498 U.S. 505 (1991), and *Kiowa Tribe of Oklahoma v. Manufacturing Technologies*, 523 U.S. 751 (1998) it appears that Native American tribes are immune from lawsuits unless either the tribe or the U.S. Congress waive tribal sovereign immunity. Is it GAO's view that in order to allow states to enforce the Jenkins Act against Native American tribes through litigation, this legislation, H.R. 1839, must unequivocally include Native American tribes as among the parties that may be sued by the states?

2. Is it the case that legislation which does not unequivocally include Native American tribes as among the parties that can be sued to enforce its terms would run the risk of leaving the states without the ability to enforce the law against Native American tribes through litigation - even if the terms of the legislation did not include an exemption for Native Americans?

<u>Response to Questions 1 and 2</u>

As stated in our August 9, 2002 report entitled *INTERNET CIGARETTE SALES: Giving ATF Investigative Authority May Improve Reporting and Enforcement*, GAO-02-743, page 18); " ***nothing in the Jenkins Act or its legislative history implies that cigarette sales for personal use, or Native American cigarette sales, are exempt."

Case law has generally concluded that if a statute uses general terms that are broad enough to include Native American tribes, as the Jenkins Act clearly does, the statute will ordinarily apply unless (1) the law touches exclusive rights of self-governance in purely intramural matters, (2) the application of the law would abrogate rights guaranteed by Indian treaties, or (3) there is proof by legislative history or some other means that Congress intended the law not to apply. We found no case law specifically applying this analysis to the Jenkins Act. The Department of Justice (DOJ) also noted this same analysis as the appropriate starting point in determining if the Jenkins Act applied to Native American tribes and noted that it also found no cases applying this three-part test to the Jenkins Act. DOJ generally concluded that Native American tribes may be subject to the Jenkins Act but its conclusion could be speculative considering the lack of case law on the subject. So, when a statute is silent on its applicability to Native American tribes, it would indeed be up to the courts to ultimately make a determination.

Also, as noted in our report and testimony, states are hampered in attempting to promote Jenkins Act compliance because they lack authority to enforce the act. H.R. 1839 currently addresses this issue by giving the Attorney General of a State the authority to bring a civil action against "any person" who violates the provisions of the Jenkins Act. As noted above, however, in the absence of statutory language expressly defining "any person" to include Native American tribes and its members, it would then be up to the courts to decide if the suit could legitimately be brought against a Native American tribe. This determination would also be left to the courts if the terms of the legislation did not specifically provide an exemption for Native Americans.

Sincerely yours,

(Signed)

Paul L. Jones
Director, Homeland Security and Justice

United States General Accounting Office

GAO

Report to Congressional Requesters

August 2002

INTERNET CIGARETTE SALES

Giving ATF Investigative Authority May Improve Reporting and Enforcement

GAO-02-743

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Figure 1: State Cigarette Excise Tax Rates, in Cents, Per Pack of 20 Cigarettes, as of January 1, 2002 5

Abbreviations

ATF	Bureau of Alcohol, Tobacco and Firearms
CCTA	Contraband Cigarette Trafficking Act
DOJ	Department of Justice
FBI	Federal Bureau of Investigation
FTA	Federation of Tax Administrators

United States General Accounting Office
Washington, DC 20548

August 9, 2002

The Honorable John Conyers
Ranking Minority Member
Committee on the Judiciary
House of Representatives

The Honorable Martin T. Meehan
House of Representatives

The Jenkins Act (15 U.S.C. §375-378) 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 tax administrator. The act establishes misdemeanor penalties for violating the act. Compliance with this federal law by cigarette sellers enables states to collect cigarette excise taxes from consumers.[1] However, some state and federal officials are concerned that as Internet cigarette sales continue to grow, particularly as states' cigarette taxes increase, so will the amount of lost state tax revenue due to noncompliance with the Jenkins Act. One research firm estimated that Internet tobacco sales in the United States will exceed $5 billion in 2005 and that the states will lose about $1.4 billion in tax revenue from these sales.[2]

You expressed concern about the extent of compliance by Internet cigarette vendors with the Jenkins Act. In response to your request, this report describes

- enforcement actions taken by the Department of Justice (DOJ) and the Bureau of Alcohol, Tobacco and Firearms (ATF) and factors that have affected the level and extent of such actions;

[1] States may also collect applicable sales and/or use taxes.

[2] *Online Tobacco Sales Grow, States Lose*, Forrester Research, Inc. (April 27, 2001). These estimates are for all tobacco products, including cigarettes which make up the majority of tobacco sales; and the tax loss estimate appears to include state cigarette excise taxes and state and local sales and use taxes. However, we were unable to assess the reliability of the estimates because the methodology used in developing it, including key assumptions and data, is proprietary.

- efforts selected states have taken to promote compliance with the Jenkins Act and estimates by these states of the impact of noncompliance on their tax revenues; and
- information on Internet cigarette vendors, including Web site addresses and other contact information, whether they indicate compliance with the act, whether they notify customers of their reporting responsibilities and the customers' potential tax liability, the average monthly volume of sales, and whether the vendors place a maximum limit on orders.

To address these areas, we obtained information from DOJ and ATF headquarters regarding federal Jenkins Act enforcement actions with respect to Internet cigarette sales. We interviewed officials and obtained documentation from nine selected states[3] regarding states' efforts to promote Jenkins Act compliance by Internet cigarette vendors and estimates of the impact of noncompliance on tax revenues. In addition, we reviewed 147 Internet cigarette vendor Web sites to obtain needed information, and we interviewed representatives of five Internet vendors.

Results in Brief

The DOJ is responsible for enforcing the Jenkins Act, and the Federal Bureau of Investigation (FBI) is the primary investigative authority. However, DOJ and FBI headquarters officials did not identify any actions taken to enforce the Jenkins Act with respect to Internet cigarette sales.

ATF has ancillary authority to enforce the Jenkins Act.[4] Since 1997, ATF has initiated three investigations of Internet cigarette vendors for cigarette

[3] As discussed in the Scope and Methodology section in app. I, we contacted tobacco tax officials in 11 states to determine whether they had undertaken efforts to promote compliance with the Jenkins Act by Internet cigarette vendors and to ask related questions. Officials in 9 states provided us with information: Alaska, California, Hawaii, Iowa, Maine, Massachusetts, Rhode Island, Washington, and Wisconsin. Officials in New Jersey and New York did not provide the information we requested in time for it to be included in the report. We selected the 10 states with the highest cigarette excise tax rates on January 1, 2002, based on the presumption these states would be among those most interested in promoting Jenkins Act compliance to collect cigarette taxes; and we selected one additional state that appeared, based on our Internet research and information from state officials we interviewed while planning our work, to have taken action to promote Jenkins Act compliance by Internet cigarette vendors.

[4] With ancillary authority to enforce the Jenkins Act, if ATF investigates a possible Contraband Cigarette Trafficking Act violation (i.e., cigarette smuggling), for which it has primary jurisdiction, and determines there is a possible Jenkins Act violation, then ATF may also investigate the Jenkins Act violation and refer it to DOJ for prosecution or injunctive relief.

smuggling, a felony offense, which included the investigation of potential Jenkins Act violations. One investigation is ongoing, another was referred to state authorities who obtained Jenkins Act compliance by the vendor without prosecution, and a third was not pursued by a grand jury. ATF is planning other actions to promote compliance with the act and address the growing issue of Internet cigarette sales. ATF officials said consideration should be given to transferring primary jurisdiction for investigating Jenkins Act violations from the FBI to ATF. According to the officials, having primary jurisdiction would give ATF comprehensive authority to enforce federal laws involving interstate cigarette distribution. The officials said ATF would use resources to specifically conduct Jenkins Act investigations, which should result in increased enforcement.

Overall, seven of nine selected states had made some effort to promote Jenkins Act compliance by Internet cigarette vendors. These efforts consisted of contacting Internet vendors and U.S. Attorneys' Offices, but they produced few results. Six of the seven states, for example, contacted Internet vendors to inform them of their Jenkins Act reporting responsibilities. However, some vendors told state officials that they did not have to comply with the Jenkins Act. For those Internet vendors that did respond by reporting cigarette sales, the states generally collected small amounts of cigarette taxes from consumers. In addition, two of the seven states asked U.S. Attorneys to help promote Jenkins Act compliance by sending letters to Internet cigarette vendors informing them of the Jenkins Act reporting requirements. The U.S. Attorneys, however, did not provide the requested assistance.

Officials in all nine states expressed concern that Internet cigarette sales would continue to increase in the future, with a growing and substantial negative effect on their tax revenues. Officials in one state, California, estimated a tax loss of approximately $13 million from May 1999 through September 2001 because of Internet cigarette vendors not complying with the Jenkins Act. However, officials in each of the states said that they lack the legal authority to successfully address this problem on their own and that greater federal action is needed to enforce the Jenkins Act. Officials in four of the states said that they believe ATF should be the federal agency with primary jurisdiction for enforcing the act.

Our Internet search efforts identified 147 Web site addresses for Internet cigarette vendors based in the United States (see app. II). None of the Web

sites posted information that indicated the vendors complied with the Jenkins Act.[5] Conversely, information posted on 78 percent of the Web sites indicated the vendors do not comply with the act. For example, 31 percent of the Web sites stated the vendors either do not report cigarette sales or do not comply with the Jenkins Act. Sixteen percent of the Web sites and four vendor representatives cited their Native American status, the Internet Tax Freedom Act, and other laws as reasons for not complying with the act. However, our review of the laws cited, as well as the Jenkins Act and its legislative history, indicates that neither Native American status nor any of the laws cited relieve Internet vendors of their Jenkins Act responsibilities. Only 5 percent of the Web sites posted notices of the vendors' reporting responsibilities under the Jenkins Act, and those that did also indicated that the vendors do not comply. Twenty-one percent of the Web sites contained statements notifying customers of their potential state tax liability for cigarette purchases or the customers' responsibility for complying with state cigarette laws.

We were able to obtain only limited information on the volume of cigarette sales by Internet vendors. Few vendor Web sites stated that the vendors have maximum limits on cigarette orders. Some vendor representatives said that the reason they had limits was to ensure that their cigarette sales are for personal use and/or to avoid violating federal cigarette smuggling law.

To improve the federal government's efforts in enforcing the Jenkins Act and promoting compliance with the act by Internet cigarette vendors, which may lead to increased state tax revenues from cigarette sales, the Congress should provide ATF with primary jurisdiction to investigate violations of the act. Transferring primary investigative jurisdiction is particularly appropriate at this time because of the FBI's new challenges and priorities related to the threat of terrorism and the FBI's increased counterterrorism efforts.

DOJ and ATF commented on a draft of this report. Both DOJ and ATF suggested that if violations of the Jenkins Act were felonies instead of misdemeanors, U.S. Attorneys' Offices might be less reluctant to prosecute violations. ATF further noted that individuals might be deterred from committing violations if they were felonies. ATF also suggested that other

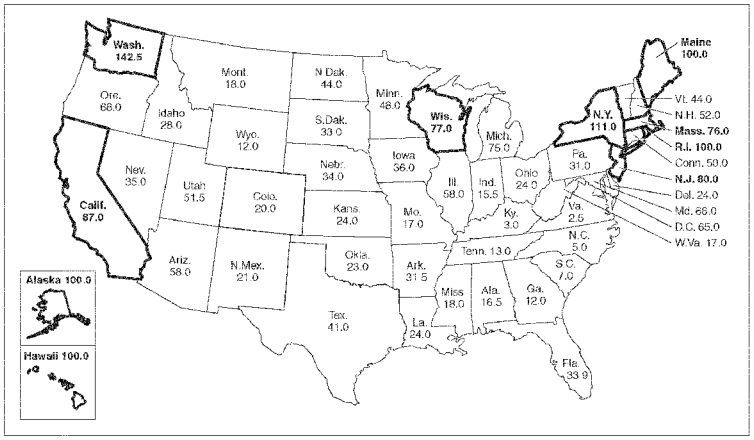
[5] The Jenkins Act does not require cigarette sellers to notify customers regarding whether or not they comply with the act's reporting requirements.

legislative changes might assist states in the collection of excise taxes on cigarettes sold over the Internet. Although we are not in a position to offer our judgment on whether violations of the Jenkins Act should be misdemeanors or felonies, or whether states would benefit from the legislative changes suggested by ATF, we believe this report provides information to help Congress make those decisions.

Background

Each state, and the District of Columbia, imposes an excise tax on the sale of cigarettes, which vary from state to state. As of January 1, 2002, the state excise tax rates for a pack of 20 cigarettes ranged from 2.5 cents in Virginia to $1.425 in Washington (see fig.1). The liability for these taxes generally arises once the cigarettes enter the jurisdiction of the state.

Figure 1: State Cigarette Excise Tax Rates, in Cents, Per Pack of 20 Cigarettes, as of January 1, 2002



Note: The 10 states highlighted had cigarette excise tax rates that were higher than the rates of the other 40 states and the District of Columbia on January 1, 2002.

Source: Developed by GAO based on Federation of Tax Administrators' data.

Many states have increased their cigarette excise taxes in recent years with the intention of increasing tax revenue and discouraging people from smoking. As a result, many smokers are seeking less costly alternatives for purchasing cigarettes, including buying cigarettes while traveling to a neighboring state with a lower cigarette excise tax. The Internet is an alternative that offers consumers the option and convenience of buying cigarettes from vendors in low-tax states without having to physically travel there.

Consumers who use the Internet to buy cigarettes from vendors in other states are liable for their own state's cigarette excise tax and, in some cases, sales and/or use taxes. States can learn of such purchases and the taxes due when vendors comply with the Jenkins Act. Under the act, cigarette vendors who sell and ship cigarettes into another state to anyone other than a licensed distributor must report (1) the name and address of the persons to whom cigarette shipments were made, (2) the brands of cigarettes shipped, and (3) the quantities of cigarettes shipped. Reports must be filed with a state's tobacco tax administrator no later than the 10th day of each calendar month covering each and every cigarette shipment made to the state during the previous calendar month. The sellers must also file a statement with the state's tobacco tax administrator listing the seller's name, trade name (if any), and address of all business locations. Failure to comply with the Jenkins Act's reporting requirements is a misdemeanor offense, and violators are to be fined not more than $1,000, or imprisoned not more than 6 months, or both. Although the Jenkins Act, enacted in 1949, clearly predates and did not anticipate cigarette sales on the Internet, vendors' compliance with the act could result in states collecting taxes due on such sales. According to DOJ, the Jenkins Act itself does not forbid Internet sales nor does it impose any taxes.

Limited Federal Involvement with the Jenkins Act and Internet Cigarette Sales

The federal government has had limited involvement with the Jenkins Act concerning Internet cigarette sales. We identified three federal investigations involving such potential violations, and none of these had resulted in prosecution (one investigation was still ongoing at the time of our work). No Internet cigarette vendors had been penalized for violating the act, nor had any penalties been sought for violators.

FBI has Primary Investigative Jurisdiction

The Attorney General of the United States is responsible for supervising the enforcement of federal criminal laws, including the investigation and prosecution of Jenkins Act violations.[6] The FBI has primary jurisdiction to investigate suspected violations of the Jenkins Act. However, DOJ and FBI officials were unable to identify any investigations of Internet cigarette vendors or other actions taken to enforce the act's provisions regarding Internet cigarette sales. According to DOJ, the FBI could not provide information on actions to investigate Jenkins Act violations, either by itself or in connection with other charges, because the FBI does not have a section or office with responsibility for investigating Jenkins Act violations and does not track such investigations. Also, DOJ said it does not maintain statistical information on resources used to investigate and prosecute Jenkins Act offenses.

In describing factors affecting the level and extent of FBI and DOJ enforcement actions with respect to the Jenkins Act and Internet cigarette sales, DOJ noted that the act creates misdemeanor penalties for failures to report information to state authorities, and appropriate referrals for suspected violations must be considered with reference to existing enforcement priorities. In this regard, we recognized that the FBI's priorities have changed. In June 2002 congressional testimony,[7] the Comptroller General noted that the FBI is at the front line of defending the public and our way of life from a new and lethal threat, that of terrorism against Americans. The Comptroller General testified that the FBI Director recognized the need to refocus priorities to meet the demands of a changing world and is now taking steps to realign resources to achieve his objectives. In May 2002, the FBI Director unveiled the second phase of a FBI reorganization, with proposed changes designed to build on initial reorganization actions taken in December 2001. A key element of the reorganization is to "redirect FBI's agent workforce to ensure that all available energies and resources are focused on the highest priority threat to the nation, i.e., terrorism." In light of the events of September 11, 2001, this shift is clearly not unexpected and is, in fact, consistent with the FBI's 1998 Strategic Plan and the current DOJ Strategic Plan. Since September 11, unprecedented levels of FBI resources have been devoted to

[6] 28 U.S.C. §533 provides that the Attorney General of the United States may appoint officials "to detect and prosecute crimes against the United States…" except where investigative jurisdiction has otherwise been assigned by law.

[7] U.S. General Accounting Office, *FBI Reorganization: Initial Steps Encouraging but Broad Transformation Needed*, GAO-02-865T (Washington, D.C.: June 21, 2002).

counterterrorism and intelligence initiatives with widespread public approval. The Comptroller General testified that enhancement of FBI resources for counterterrorism and other planned actions seem to be rational steps to building agency capacity to fight terrorism.

ATF has Ancillary Enforcement Authority

ATF, which enforces federal excise tax and criminal laws and regulations related to tobacco products, has ancillary authority to enforce the Jenkins Act. ATF special agents investigate trafficking of contraband tobacco products in violation of federal law and sections of the Internal Revenue Code. For example, ATF enforces the Contraband Cigarette Trafficking Act (CCTA), which makes it unlawful for any person to ship, transport, receive, possess, sell, distribute, or purchase more than 60,000 cigarettes that bear no evidence of state cigarette tax payment in the state in which the cigarettes are found, if such state requires a stamp or other indicia to be placed on cigarette packages to demonstrate payment of taxes (18 U.S.C. 2342).[8] ATF is also responsible for the collection of federal excise taxes on tobacco products and the qualification of applicants for permits to manufacture tobacco products, operate export warehouses, or import tobacco products. ATF inspections verify an applicant's qualification information, check the security of the premise, and ensure tax compliance.

To enforce the CCTA, ATF investigates cigarette smuggling across state borders to evade state cigarette taxes, a felony offense. Internet cigarette vendors that violate the CCTA, either directly or by aiding and abetting others, can also be charged with violating the Jenkins Act if they failed to comply with the act's reporting requirements. ATF can refer Jenkins Act matters uncovered while investigating CCTA violations to DOJ or the appropriate U.S. Attorney's Office for charges to be filed. ATF officials identified three investigations since 1997 of Internet vendors for cigarette smuggling in violation of the CCTA and violating the Jenkins Act.

- In 1997, a special agent in ATF's Anchorage, Alaska, field office noticed an advertisement by a Native American tribe in Washington that sold cigarettes on the Internet. ATF determined from the Alaska Department of Revenue that the vendor was not reporting cigarette sales as required by the Jenkins Act, and its investigation with another ATF office showed that the vendor was shipping cigarettes into Alaska.

[8] Certain persons, including permit holders under the Internal Revenue Code, common carriers with proper bills of lading, or individuals licensed by the state where the cigarettes are found, may possess these cigarettes (18 U.S.C. 2341).

After ATF discussed potential cigarette smuggling and Jenkins Act violations with the U.S. Attorney's Office for the District of Alaska, it was determined there was no violation of the CCTA.[9] The U.S. Attorney's Office did not want to pursue only a Jenkins Act violation, a misdemeanor offense,[10] and asked ATF to determine whether there was evidence that other felony offenses had been committed. Subsequently, ATF formed a temporary task force with Postal Service inspectors and state of Alaska revenue agents, which demonstrated to the satisfaction of the U.S. Attorney's Office that the Internet cigarette vendor had committed mail fraud. The U.S. Attorney's Office agreed to prosecute the case and sought a grand jury indictment for mail fraud, but not for violating the Jenkins Act. The grand jury denied the indictment.[11] In a letter dated September 1998, the U.S. Attorney's Office requested that the vendor either cease selling cigarettes in Alaska and file the required Jenkins Act reports for previous sales, or come into compliance with the act by filing all past and future Jenkins Act reports. In another letter dated December 1998, the U.S. Attorney's Office instructed the vendor to immediately comply with all requirements of the Jenkins Act. However, an official at the Alaska Department of Revenue told us that the vendor never complied. No further action has been taken.

- Another investigation, carried out in 1999, involved a Native American tribe selling cigarettes on the Internet directly to consumers and other tribes. The tribe was not paying state tobacco excise taxes or notifying states of cigarette sales to other than wholesalers, as required by the Jenkins Act. ATF referred the case to the state of Arizona, where it was resolved with no criminal charges filed by obtaining the tribe's agreement to comply with Jenkins Act requirements.

- A third ATF investigation of an Internet vendor for cigarette smuggling and Jenkins Act violations was ongoing at the time of our work.

[9] The U.S. Attorney's Office determined there was no CCTA violation because the state of Alaska did not require that tax stamps be placed on cigarette packages as evidence that state taxes were paid.

[10] According to DOJ, legal considerations and professional obligations preclude DOJ from discussing the specific reasons for such decisions by a U.S. Attorney's Office in a particular case.

[11] DOJ could not disclose the reason the indictment was denied because, according to DOJ, Rule 6(e) of the Federal Rules of Criminal Procedure bars DOJ from discussing matters occurring before a grand jury.

On January 31, 2002, the Commissioner of the Connecticut Department of Revenue Services sent a letter to the Director of ATF requesting assistance in addressing the growing problem of Internet and mail order cigarette sales without Jenkins Act compliance. The ATF Director responded to the Commissioner by letter dated April 5, 2002. The ATF Director expressed concern about growing Internet cigarette sales and the impact on collection of state cigarette excise taxes. The Director highlighted three initiatives ATF is planning to help address this problem.

- ATF will solicit the cooperation of tobacco manufacturers and determine who is selling cigarettes to Internet and mail order companies. ATF believes the tobacco manufacturers will render support and place their distributors on notice that some of their customers' business practices may be defrauding states of tax revenues. The Director said ATF will remind the tobacco manufacturers of Jenkins Act requirements and that sales involving Native Americans are not exempt.

- ATF will contact shippers/couriers to determine if they have any prohibitions against the shipment of cigarettes. ATF will also inform them of the likelihood that some of their customers are selling cigarettes on the Internet and violating the Jenkins Act, as well as potentially committing mail fraud, wire fraud, and money laundering offenses. ATF will request that the common carriers be more vigilant and conscientious regarding their customers and the laws they could be violating.

- According to the Director, ATF will provide technical assistance to the state of Connecticut or members of the U.S. Congress working with Connecticut on a legislative response to address the issue of tobacco sales on the Internet.

ATF officials said that because ATF does not have primary Jenkins Act jurisdiction, it has not committed resources to investigating violations of the act. However, the officials said strong consideration should be given to transferring primary jurisdiction for investigating Jenkins Act violations from the FBI to ATF. According to ATF, it is responsible for, and has committed resources to, regulating the distribution of tobacco products and investigating trafficking in contraband tobacco products. A change in Jenkins Act jurisdiction would give ATF comprehensive authority at the federal level to assist states in preventing the interstate distribution of cigarettes resulting in lost state cigarette taxes since ATF already has investigative authority over the CCTA, according to the officials. The

officials also told us ATF has special agents and inspectors that obtain specialized training in enforcing tax and criminal laws related to tobacco products, and, with primary jurisdiction, ATF would have the investigative authority and would use resources to specifically conduct investigations to enforce the Jenkins Act, which should result in greater enforcement of the act than in the past.

States Have Taken Action to Promote Jenkins Act Compliance by Internet Cigarette Vendors, but Results Were Limited

Officials in nine states that provided us information all expressed concern about Internet cigarette vendors' noncompliance with the Jenkins Act and the resulting loss of state tax revenues. For example, California officials estimated that the state lost approximately $13 million in tax revenue from May 1999 through September 2001, due to Internet cigarette vendors' noncompliance with the Jenkins Act. Overall, the states' efforts to promote compliance with the act by Internet vendors produced few results. Officials in the nine states said that they lack the legal authority to successfully address this problem on their own. They believe greater federal action is needed, particularly because of their concern that Internet cigarette sales will continue to increase with a growing and substantial negative effect on tax revenues.

States' Efforts Produced Limited Results

Starting in 1997, seven of the nine states had made some effort to promote Jenkins Act compliance by Internet cigarette vendors. These efforts involved contacting Internet vendors and U.S. Attorneys' Offices. Two states had not made any such efforts.

Six of the seven states tried to promote Jenkins Act compliance by identifying and notifying Internet cigarette vendors that they are required to report the sale of cigarettes shipped into those states. Generally, officials in the six states learned of Internet vendors by searching the Internet, noticing or being told of vendors' advertisements, and by state residents or others notifying them. Five states sent letters to the identified vendors concerning their Jenkins Act reporting responsibilities, and one state made telephone calls to the vendors.

After contacting the Internet vendors, the states generally received reports of cigarette sales from a small portion of the vendors notified.[12] The states

[12] Cigarette vendors are not required to report to a state unless they sell and ship cigarettes into the state. Consequently, the states do not know if the Internet vendors that were notified but did not respond had any cigarette sales to report.

then contacted the state residents identified in the reports, and they collected taxes from most of the residents contacted. When residents did not respond and pay the taxes due, the states carried out various follow-up efforts, including sending additional notices and bills, assessing penalties and interest, and deducting amounts due from income tax refunds. Generally, the efforts by the six states to promote Jenkins Act compliance were carried out periodically and required few resources. For example, a Massachusetts official said the state notified Internet cigarette vendors on five occasions starting in July 2000, with one employee working a total of about 3 months on the various activities involved in the effort.

Table 1 summarizes the six states' efforts to identify and notify Internet cigarette vendors about the Jenkins Act reporting requirements and shows the results that were achieved. There was little response by the Internet vendors notified. Some of the officials told us that they encountered Internet vendors that refused to comply and report cigarette sales after being contacted. For example, several officials noted that Native Americans often refused to report cigarette sales, with some Native American vendors citing their sovereign nation status as exempting them from the Jenkins Act, and others refusing to accept a state's certified notification letters. Also, an attorney for one vendor informed the state of Washington that the vendor would not report sales because the Internet Tax Freedom Act relieved the vendor of Jenkins Act reporting requirements.

Table 1: Summary of Six States' Efforts to Promote Jenkins Act Compliance Since 1997

State	Number of Internet vendors identified and notified	Number of Internet vendors that responded with reports of cigarette sales	Number of residents identified and notified	Number of residents that responded	Amount of taxes, penalties, and interest collected[a]
Alaska	15[b,c]	2	3	1	$9,850
California	167 (approx.)[c,d]	20 (approx.)	23,500 (approx.)	13,500 (approx.)	$1.4 million (approx.)
Massachusetts	262	13	None[e]	None	None
Rhode Island	Number unknown	None[f]	None	None	None
Washington	186	8	800 (approx.)	560 (approx.)	$29,898
Wisconsin	21	6	696	696	$80,200

Note: Massachusetts' data are as of May 2002, Washington and Wisconsin's data are as of April 2002, Alaska's and Rhode Island's data are as of March 2002, and California's data are through September 2001.

[a]Not all states collected penalties and interest, and some of the amounts paid include sales and use taxes in addition to cigarette excise taxes. Some of the amounts paid by residents were for more cigarette purchases than the vendors reported to the state.

[b]Alaska identified 17 vendors, but did not know where 2 were located and could not notify them.

[c]Alaska and California sent ATF a copy of each letter mailed to Internet cigarette vendors notifying them of their Jenkins Act reporting responsibilities.

[d]California started its Internet/Mail Order Program in May 1999. Through September 2001, 196 vendors had been identified and notified, of which about 85 percent, or approximately 167, were Internet vendors. All 20 vendors that responded were Internet vendors.

[e]At the time of our work, Massachusetts had not notified the residents identified in reports provided by the 13 vendors that responded out of the 262 vendors notified because the state was in the process of developing policy regarding Jenkins Act compliance and reports of residents' Internet cigarette purchases.

[f]No Internet cigarette vendors reported cigarette sales in response to Rhode Island notifying them of their Jenkins Act reporting responsibilities.

Source: Developed by GAO from data provided by the above states.

Apart from the states' efforts to identify and notify Internet cigarette vendors, state officials noted that some Internet vendors voluntarily complied with the Jenkins Act and reported cigarette sales on their own. The states subsequently contacted the residents identified in the reports to collect taxes. For example, a Rhode Island official told us there were three or four Internet vendors that voluntarily reported cigarette sales to the state. Based on these reports, Rhode Island notified about 400 residents they must pay state taxes on their cigarette purchases and billed these residents over $76,000 (the Rhode Island official that provided this information did not know the total amount collected). Similarly, Massachusetts billed 21 residents for cigarette taxes and collected $2,150 based on reports of cigarette sales voluntarily sent to the state.

Three of the seven states that made an effort to promote Jenkins Act compliance by Internet cigarette vendors contacted U.S. Attorneys and requested assistance. The U.S. Attorneys, however, did not provide the assistance requested. The states' requests and responses by the U.S. Attorneys' Offices are summarized below.

- In March 2000, Iowa and Wisconsin officials wrote letters to three U.S. Attorneys in their states requesting assistance. The state officials asked the U.S. Attorneys to send letters to Internet vendors the states had identified, informing the vendors of the Jenkins Act and directing them to comply by reporting cigarette sales to the states. The state officials provided a draft letter and offered to handle all aspects of the mailings. The officials noted they were asking the U.S. Attorneys to send the letters over their signatures because the Jenkins Act is a federal law and a statement from a U.S. Attorney would have more impact than from a state official. However, the U.S. Attorneys did not provide the assistance requested. According to Iowa and Wisconsin officials, two U.S. Attorneys' Offices said they were not interested in helping, and one did not respond to the state's request.[13]

- After contacting the FBI regarding an Internet vendor that refused to report cigarette sales, saying that the Internet Tax Freedom Act relieved the vendor of Jenkins Act reporting requirements, the state of Washington acted on the FBI's recommendation and wrote a letter in April 2001 requesting that the U.S. Attorney initiate an investigation. According to a Washington official, the U.S. Attorney's Office did not pursue this matter and noted that a civil remedy (i.e., lawsuit) should be sought by the state before seeking a criminal action.[14] At the time of our work, the state was planning to seek a civil remedy.

- In July 2001, the state of Wisconsin wrote a letter referring a potential Jenkins Act violation to the U.S. Attorney for prosecution. According to a Wisconsin official, this case had strong evidence of Jenkins Act noncompliance—there were controlled and supervised purchases made on the Internet of a small number of cartons of cigarettes, and

[13] DOJ noted that federal prosecutors generally do not issue advisory opinions about prosecutive matters, as they may subsequently be presented with the need to make an actual decision based on specific facts. The issuance of such an opinion might create the basis for a legal dispute if a subsequent prosecution were undertaken.

[14] According to DOJ, legal considerations and professional obligations preclude DOJ from discussing the specific reasons for such decisions by a U.S. Attorney's Office in a particular case.

the vendor had not reported the sales to Wisconsin. The U.S. Attorney's Office declined to initiate an investigation, saying that it appeared this issue would be best handled by the state "administratively."[15] The Wisconsin official told us, however, that Wisconsin does not have administrative remedies for Jenkins Act violations, and, in any case, the state cannot reach out across state lines to deal with a vendor in another state.

States Concerned about Internet Vendors' Noncompliance and Believe Greater Federal Action is Needed

Officials in each of the nine states expressed concern about the impact that Internet cigarette vendors' noncompliance with the Jenkins Act has on state tax revenues. The officials said that Internet cigarette sales will continue to grow in the future and are concerned that a much greater and more substantial impact on tax revenues will result. One state, California, estimated that its lost tax revenue due to noncompliance with the Jenkins Act by Internet cigarette vendors was approximately $13 million from May 1999 through September 2001.[16]

Officials in all nine states said that they are limited in what they can accomplish on their own to address this situation and successfully promote Jenkins Act compliance by Internet cigarette vendors. All of the officials pointed out that their states lack the legal authority necessary to enforce the act and penalize the vendors who violate it, particularly with the vendors residing in other states. Officials in three states told us that efforts to promote Jenkins Act compliance are not worthwhile because of such limitations, or are not a priority because of limited resources.

Officials in all nine states said that they believe greater federal action is needed to enforce the Jenkins Act and promote compliance by Internet cigarette vendors. Four state officials also said they believe ATF should have primary jurisdiction to enforce the act. One official pointed out that his organization sometimes dealt with ATF on tobacco matters, but has never interacted with the FBI. Officials in the other five states did not

[15] According to DOJ, legal considerations and professional obligations preclude DOJ from discussing the specific reasons for such decisions by a U.S. Attorney's Office in a particular case.

[16] The Excise Taxes Division, California State Board of Equalization, did not make an official analyses of lost revenue. The $12.75 million estimate is a projection by the division based on the amount of state excise and use taxes determined as due from cigarette sales reported by out-of-state Internet vendors during the period of May 1999 through September 2001.

express an opinion regarding which federal agency should have primary jurisdiction to enforce the act.

Most Internet Cigarette Vendors Do Not Comply with the Jenkins Act, Notify Consumers of Their Responsibilities, or Provide Information on Sales Volume

Through our Internet search efforts (see app. I), we identified 147 Web site addresses for Internet cigarette vendors based in the United States and reviewed each Web site linked to these addresses.[17] Our review of the Web sites found no information suggesting that the vendors comply with the Jenkins Act. Some vendors cited reasons for not complying that we could not substantiate. A few Web sites specifically mentioned the vendors' Jenkins Act reporting responsibilities, but these Web sites also indicated that the vendors do not comply with the act. Some Web sites provided notice to consumers of their potential state tax liability for Internet cigarette purchases. We also found that information on vendor cigarette sales volume is very limited, and few of the Web sites we reviewed posted maximum limits for online cigarette orders.

Majority of Web sites Indicate that Vendors do Not Comply with the Jenkins Act

None of the 147 Web sites we reviewed stated that the vendor complies with the Jenkins Act and reports cigarette sales to state tobacco tax administrators.[18] Conversely, as shown in table 2, information posted on 114 (78 percent) of the Web sites indicated the vendors' noncompliance with the act through a variety of statements posted on the sites. Thirty-three Web sites (22 percent) provided no indication about whether or not the vendors comply with the act.

[17] The 147 Web site addresses appear to represent 122 different Internet cigarette vendors. We made this determination by comparing information such as vendor names, company names, street addresses, P.O. Box numbers, and telephone numbers. For example, some Web sites had the same mailing address and telephone number, suggesting they were separate Web sites being operated by one company. The vendors' Web site addresses and other contact information is listed in appendix II.

[18] Two Web sites posted statements indicating that customer information would be released if required; however, both sites also stated that the information would not be given out without the customers' permission. The Jenkins Act does not require cigarette sellers to notify customers regarding whether or not they comply with the act's reporting requirements.

Table 2: Web sites indicating Internet Cigarette Vendors' Noncompliance with the Jenkins Act

Web site statement indicating noncompliance	Number	Percent
Do not report sales to state tax authorities	44[a]	30
Do not comply with the Jenkins Act	1	1
Keep customer information private	43	29
Silent on reporting, but claim cigarettes are tax-free	26	18
Total	**114**	**78**

[a]One Web site stated that it does not report to state tax authorities and that it does not comply with the Jenkins Act. In determining the number of Web sites indicating noncompliance with the Jenkins Act, we counted this only as a statement that it does not comply with the act.

Source: GAO's analysis of Web site data.

Reasons Cited for Noncompliance with the Jenkins Act

Some Internet vendors cited specific reasons on their Web sites for not reporting cigarette sales to state tax authorities as required by the Jenkins Act. Seven of the Web sites reviewed (5 percent) posted statements asserting that customer information is protected from release to anyone, including state authorities, under privacy laws. Seventeen Web sites (12 percent) state that they are not required to report information to state tax authorities and/or are not subject to the Jenkins Act reporting requirements. Fifteen of these 17 sites are Native American, with 7 of the sites specifically indicating that they are exempt from reporting to states either because they are Native American businesses or because of their sovereign nation status. In addition, 35 Native American Web sites (40 percent of all the Native American sites we reviewed) indicate that their tobacco products are available tax-free because they are Native American businesses.[19]

To supplement our review of the Web sites, we also attempted to contact representatives of 30 Internet cigarette vendors, and we successfully interviewed representatives of 5.[20] One of the 5 representatives said that the vendor recently started to file Jenkins Act sales reports with one

[19] Fifty-nine percent, or 87, of the 147 Web site addresses reviewed are either Native American-owned or located and/or operated on Native American lands.

[20] We were either unable to reach representatives of the remaining 25 vendors we selected to conduct structured interviews, or they declined to answer questions. Our methodology for interviewing vendor representatives is discussed in appendix I.

state.[21] However, the other 4 said that they do not comply with the act and provided us with additional arguments for noncompliance. Their arguments included an opinion that the act was not directed at personal use. An additional argument was that the Internet Tax Freedom Act[22] supercedes the obligations laid out in the Jenkins Act.

Our review of the applicable statutes indicates that neither the Internet Tax Freedom Act nor any privacy laws exempt Internet cigarette vendors from Jenkins Act compliance. The Jenkins Act has not been amended since minor additions and clarifications were made to its provisions in 1953 and 1955; and neither the Internet Tax Freedom Act nor any privacy laws amended the Jenkins Act's provisions to expressly exempt Internet cigarette vendors from compliance. With regard to the Internet Tax Freedom Act, the temporary ban that the act imposed on certain types of taxes on e-commerce did not include the collection of existing taxes, such as state excise, sales, and use taxes.

Additionally, nothing in the Jenkins Act or its legislative history implies that cigarette sales for personal use, or Native American cigarette sales, are exempt. In examining a statute, such as the Jenkins Act, that is silent on its applicability to Native American Indian tribes, courts have consistently applied a three-part analysis. Under this analysis, if the act uses general terms that are broad enough to include tribes, the statute will ordinarily apply unless (1) the law touches "exclusive rights of self-governance in purely intramural matters;" (2) the application of the law to the tribe would abrogate rights guaranteed by Indian treaties; or (3) there is proof by legislative history or some other means that Congress intended the law not to apply to Indians on their reservations. Our review of the case law did not locate any case law applying this analysis to the Jenkins Act. DOJ said that it also could not locate any case law applying the analysis to the Jenkins Act, and DOJ generally concluded that an Indian tribe may be subject to the act's requirements. DOJ noted, however, that considering the lack of case law on this issue, this conclusion is somewhat speculative. ATF has said that sales or shipments of cigarettes from Native

[21] The vendor who said that he does comply with the Jenkins Act told us that he recently started to file reports with the state of Washington after receiving a notice from the state's Department of Revenue. However, he said Washington is the only state he reports to, and he declined to provide us with evidence of his compliance with the act.

[22] P.L. 105-277, Div. C, Title XI, Oct. 21, 1998.

American reservations are not exempt from the requirements of the Jenkins Act.[23]

Few Web sites Provide Notice of the Vendors' Reporting Responsibilities, but Some Provide Notice of Customer Cigarette Tax Liability

Only 8 (5 percent) of the 147 Web sites we reviewed notified customers that the Jenkins Act requires the vendor to report cigarette sales to state tax authorities, which could result in potential customer tax liability. However, in each of these cases, the Web sites that provided notices of Jenkins Act responsibilities also followed the notice with a statement challenging the applicability of the act and indicating that the vendor does not comply. Twenty-eight Web sites (19 percent) either provided notice of potential customer tax liability for Internet cigarette purchases or recommended that customers contact their state tax authorities to determine if they are liable for taxes on such purchases. Three other sites (2 percent) notified customers that they are responsible for complying with cigarette laws in their state, but did not specifically mention taxes. Of the 147 Web sites we reviewed, 108 (73 percent) did not provide notice of either the vendors' Jenkins Act reporting responsibilities or the customers' responsibilities, including potential tax liability, with regard to their states.

Minimal Information Available on Vendor Cigarette Sales Volume; Some Vendors Post Maximum Limits on Orders on Their Web sites

We attempted to collect average monthly sales volume data through our interviews with representatives of Internet cigarette vendors. Two of the five vendor representatives we interviewed provided us with information on average monthly sales volume. One said that he sells approximately 500 cartons a month. The other (who operates two Web sites) referred us to information in his federal Securities and Exchange Commission (SEC) filings.[24] We reviewed a company filing from February 2001 and found that it did not contain data on monthly volume by carton.[25] The information did, however, indicate that the company's revenues from cigarette sales from both Web sites averaged just over $196,000 a month in 2000. The remaining three vendor representatives we interviewed declined to answer specific questions on sales volume. Several of the representatives we spoke with said that the majority of vendors process a low number of cartons each

[23] *Industry Circular*, No. 99-2, Bureau of Alcohol, Tobacco and Firearms, June 6, 1999.

[24] The SEC requires public companies to disclose meaningful financial and other information to the public through a variety of forms and filings.

[25] We reviewed the company's 10K-SB filing. This is the annual report filed with the SEC by small business issuers. The report provides a comprehensive overview of the company's business and must be filed within 90 days after the end of the company's fiscal year.

month and that only a small number of companies sell any significant volume.

Twenty-four (16 percent) of the Web sites we reviewed posted a maximum limit on the number of cigarette cartons that can be ordered through the sites. These limits ranged from a maximum of two cartons per person per order to a maximum of 300 cartons per order. Two of the 24 Web sites specified that the limits were per day and not per order (i.e., maximum purchases of 49 and 149 cartons per day). Three of the vendor representatives we interviewed, including one that does not post a maximum limit on orders, said that they monitor the size of orders and flag any order over a certain amount for manual review and processing. Three vendor representatives said that the reason they have maximum limits and/or monitoring procedures in place is to ensure that their cigarettes are sold for personal use only and not for resale. One representative told us that he believes the CCTA limits the amount of cigarettes he can sell to 300 cartons per day.[26]

Conclusions

States are hampered in attempting to promote Jenkins Act compliance because they lack authority to enforce the act. In addition, violation of the act is a misdemeanor, and U.S. Attorneys' reluctance to pursue misdemeanor violations could be contributing to limited enforcement. Transferring primary investigative jurisdiction from the FBI to ATF would give ATF comprehensive authority at the federal level to enforce the Jenkins Act and should result in more enforcement. ATF's ability to couple Jenkins Act and CCTA enforcement may increase the likelihood it will detect and investigate violators and that U.S. Attorneys will prosecute them. This could lead to improved reporting of interstate cigarette sales, thereby helping to prevent the loss of state cigarette tax revenues. Transferring primary investigative jurisdiction is also appropriate at this time because of the FBI's new challenges and priorities related to the threat of terrorism and the FBI's increased counterterrorism efforts.

[26] The CCTA does not limit the number of cartons that can be sold in a day. As noted on page 8, the CCTA makes it unlawful for any person to ship, transport, receive, possess, sell, distribute, or purchase more than 60,000 cigarettes (i.e., more than 300 cartons containing packs of 20 cigarettes) that bear no evidence of state cigarette tax payment in the state in which the cigarettes are found, if such state requires a stamp or other indicia to be placed on cigarette packages to demonstrate payment of taxes (18 U.S.C. 2342).

Matters for Congressional Consideration

To improve the federal government's efforts in enforcing the Jenkins Act and promoting compliance with the act by Internet cigarette vendors, which may lead to increased state tax revenues from cigarette sales, the Congress should consider providing ATF with primary jurisdiction to investigate violations of the Jenkins Act (15 U.S.C. §375-378).

Agency Comments

DOJ and ATF provided written comments on a draft of this report. The agencies' comments are shown in appendixes III and IV, respectively.

Both DOJ and ATF suggested that if violations of the Jenkins Act were felonies instead of misdemeanors, U.S. Attorneys' Offices might be less reluctant to prosecute violations. ATF further noted that individuals might be deterred from committing Jenkins Act violations if they were felonies.

ATF also suggested that other legislative changes might assist states in the collection of excise taxes on cigarettes sold over the Internet: (1) amend the Jenkins Act to give states the authority to seek injunctions in federal court to prevent businesses violating the act from shipping cigarettes to their residents, similar to a recent amendment to the Webb-Kenyon Act, 27 U.S.C. 122, giving states this authority for alcohol shipments; (2) amend 18 U.S.C. 1716 (f) to prohibit the mailing of cigarettes and other tobacco products through the U.S. Postal Service as this law now does for alcoholic beverage products; and (3) enact federal law establishing requirements for the delivery of cigarettes by common carriers such as Federal Express and UPS (e.g., notify states of shipments, require proof of age before delivery) modeled after 18 U.S.C. Chapter 59 (Sections 1261, et. seq.), which restricts how common carriers may ship alcohol.

Although we are not in a position to offer our judgment on whether violations of the Jenkins Act should be misdemeanors or felonies, or whether states would benefit from the legislative changes suggested by ATF, we believe this report provides information to help Congress make those decisions.

DOJ also provided technical comments on the draft report, which we have incorporated into the report.

We are sending copies of this report to the Chairman, House Committee on the Judiciary; the Attorney General; the Secretary of the Treasury; and other interested parties. We will also make copies available to others upon

request. In addition, the report will be available at no charge on GAO's Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please call me at (202) 512-8777 or Darryl W. Dutton at (213) 830-1000. Other key contributors to this report were Ronald G. Viereck, Sarah M. Prehoda, Shirley A. Jones, and Evan B. Gilman.

Paul L. Jones
Director, Justice Issues

Appendix I: Scope and Methodology

To determine actions taken by the Department of Justice (DOJ) and the Bureau of Alcohol, Tobacco and Firearms (ATF) to enforce the Jenkins Act with regard to Internet cigarette sales and factors that may have affected the level and extent of such actions, we provided written questions to DOJ and ATF headquarters requesting the needed information. We interviewed ATF officials and obtained documentation to clarify responses to some of our written questions and acquire additional information.

To determine efforts taken by selected states to promote compliance with the Jenkins Act by Internet cigarette vendors, we contacted tobacco tax authorities in 11 states (Alaska, California, Hawaii, Iowa, Maine, Massachusetts, New Jersey, New York, Rhode Island, Washington, and Wisconsin) to obtain information. We selected the 10 states with the highest cigarette excise tax rates on January 1, 2002, based on the presumption these states would be among those most interested in promoting Jenkins Act compliance to collect cigarette taxes, and we selected one additional state (Iowa) that appeared, based on our Internet research and information from state officials we interviewed while planning our work, to have taken action to promote Jenkins Act compliance by Internet cigarette vendors. Using an ATF circular listing state tobacco tax contacts' telephone numbers for questions regarding state cigarette taxes and reporting requirements, we contacted officials at the Tax Division, Alaska Department of Revenue; Excise Taxes Division, California State Board of Equalization; Department of Taxation, State of Hawaii; Compliance Division, Iowa Department of Revenue and Finance; Sales and Special Tax Division, Maine Revenue Services; Excise Tax Unit (within the Processing Division) and Legal Division, Massachusetts Department of Revenue; Office of Criminal Investigation, New Jersey Division of Taxation; Transaction and Transfer Tax Bureau, New York State Department of Taxation and Finance; Excise Tax Section, Rhode Island Division of Taxation; Special Programs Division and Legislation and Policy Division, Washington Department of Revenue; and Alcohol and Tobacco Enforcement Section, Income, Sales and Excise Tax Division, Wisconsin Department of Revenue.

After contacting these state agencies, we collected information from 9 of the 11 states (New Jersey and New York did not provide the information we requested in time for it to be included in the report) by interviewing officials and obtaining documentation. We collected data on the states' efforts to contact Internet cigarette vendors, including how they identified vendors and notified them of their Jenkins Act responsibilities, and the results of these efforts in terms of the level of response by vendors and the

resulting collection of cigarette excise taxes from consumers. We collected information on contacts the states had with DOJ and ATF in carrying out efforts to promote Jenkins Act compliance by Internet cigarette vendors and reporting potential vendor noncompliance. We asked the states to identify impediments to their efforts to promote compliance with the act by Internet cigarette vendors. We also asked the states whether greater federal action is needed to promote greater compliance by Internet cigarette vendors. In addition, we asked for any estimates made by these states of the impact on state tax revenues of noncompliance with the Jenkins Act by Internet cigarette vendors. We did not independently verify the accuracy and reliability of the data provided to us by officials in the 9 states.

We also collected information regarding states from two other sources. From the Federation of Tax Administrators (FTA) Internet Web site, we obtained each state's cigarette excise tax rate that was in effect on January 1, 2002. FTA is a national organization with a mission to improve the quality of state tax administration by providing services to state tax authorities and administrators. The principal tax collection agencies of the 50 states, the District of Columbia, and New York City are the members of FTA. We also contacted Forrester Research, Inc., a private research firm, and obtained a copy of a research brief discussing Internet tobacco sales ("Online Tobacco Sales Grow, States Lose;" April 27, 2001). This brief forecasts Internet tobacco sales in the United States for each year from 2001 through 2005 and estimates the total lost state tax revenue from such sales for each of those years.

To determine readily identifiable Internet cigarette vendors, including their Web site addresses and other contact information, we developed a list of Web site addresses by conducting searches using two major Internet search engines (Brint and Google).[1] To conduct the searches, we used the key words "discount cigarettes," "cheap cigarettes," and "online cigarette sales" as if we were consumers. We used the results of the two searches to compile a universe of 229 Web site addresses for Internet cigarette

[1] We used Brint and Google Internet search engines because they produced lists that consisted almost entirely of Internet cigarette vendors. Other search engines we tried produced lists containing cigarette vendors and thousands of other Web sites, such as cigarette manufacturers, cigarette advocacy sites, and newspapers with articles on cigarettes.

vendors.[2] We reviewed each of the 229 Web sites using a data collection instrument (DCI) we developed, and we collected contact information such as vendor or company names, addresses, and telephone numbers. Upon completing this review, we eliminated 82 Web sites from our universe: 35 Web sites that either did not sell cigarettes or would not open and 47 Web sites that were either located outside of the United States or represented companies, warehouses, or ordering desks located outside the United States.[3] The remaining 147 Web site addresses make up our universe of readily identifiable Internet cigarette vendors.[4] This universe does not necessarily represent all Internet cigarette vendors operating in the United States. Other researchers, state officials, and industry representatives have used various different methodologies and inclusion criteria to identify Internet cigarette vendors and have produced estimates ranging from 88 to about 400 vendors.

To determine whether the 147 readily identifiable Internet cigarette vendor Web sites (1) indicate that the vendors comply with the Jenkins Act; (2) accurately notify potential customers of the vendors' reporting responsibilities under the Jenkins Act and the customers' potential tax liability; and (3) place a maximum limit on cigarette orders, we reviewed each of the 147 Web sites using our DCI. We reviewed all Web site statements and notices regarding matters such as vendor policies, practices, privacy concerns, government requirements, vendor responsibilities, vendor compliance with the act, customer responsibilities, potential customer tax liability, as well as any limits on cigarette orders. In doing so, we examined all the pages on each of the Web sites, including the ordering screens, and proceeded as far as possible in the ordering process without inputting any requested personal information. We analyzed the DCIs to derive descriptive statistics

[2] One Web site that was on both the Brint and Google search lists was a directory for online cigarette sales. This directory contained 10 Internet cigarette vendor Web sites that were not listed separately by the Brint and Google search engines. We included these 10 Web sites in our universe.

[3] We focused our review on U.S.-based Internet cigarette vendors because it is unclear whether the Jenkins Act applies to foreign vendors. Neither the law itself nor its legislative history directly addresses its applicability to foreign vendors.

[4] The 147 Web site addresses appear to represent 122 different Internet cigarette vendors. We made this determination by comparing information such as vendor names, company names, street addresses, P.O. Box numbers, and telephone numbers. For example, some Web sites had the same mailing address and telephone number, suggesting they were separate Web sites being operated by one company.

regarding the Web sites' statements and notices, and we summarized reasons cited on the Web sites for vendors not complying with the Jenkins Act.

To determine (1) whether readily identifiable Internet cigarette vendors can provide evidence of compliance with the Jenkins Act, (2) the average monthly volume of Internet cigarette sales reported by vendors, and (3) whether vendors place a maximum limit on orders to prevent large-scale tax evasion by purchasers who plan to resell cigarettes, we attempted to conduct structured interviews on the telephone with representatives of 30 of the 147 Internet cigarette vendors. We judgmentally selected 13 of these vendors based on, and to ensure diversity among, geographic location and whether or not the vendors were owned by Native Americans or located on Native American lands. We used information from our DCIs to randomly select another 17 vendors from three categories: (1) those with Web sites silent on whether or not they comply with the Jenkins Act, (2) those who placed maximum limits on cigarette orders on their Web sites, and (3) all remaining Web sites. Table 3 provides the results of our attempts to interview representatives of the 30 vendors on the telephone.

Table 3: Results of Attempts to Interview 30 Internet Cigarette Vendor Representatives

Result of telephone calls	Number of vendors
Successfully interviewed representative	5
Refused to answer questions	7
Did not return messages	14
Inaccurate telephone number	2
Constant busy signal	2
Total	**30**

Source: Developed by GAO.

We conducted our work between December 2001 and May 2002 in accordance with generally accepted government auditing standards.

Appendix II: List of GAO-Identified Internet Cigarette Vendors' Web site Addresses and Other Contact Information

www.001cigarettes.com

001Cigarettes.com
25 Church St
Salamanca, NY 14779
(800) 240-8501

www.0taxcigs.com

0TaxCigs.com

www.0taxsmokes.com

RJ's Tobacco Emporium
200 West State St
Salamanca, NY 14779
(800) 720-0475

www.4cheapcigs.com

4 Cheap Cigs
13967 Four Mile Level Rd
Gowanda, NY 14070
(800) 340-9098 or (716) 532-5941

www.a1cigs.com

A1Cigs.com
PO Box 36837
Albuquerque, NM 87176
(866) 264-4060

www.a1discountcigarettes.com

A-1 Discount Cigarettes
PO Box 457
Big Stone Gap, VA 24219
(888) 776-2099

www.a1discountsmokes.com

A1DiscountSmokes.com
31 Church St Suite C
Salamanca, NY 14779
(866) 217-6653

www.aaasmokes.com

AAA Smokes
PO Box 457
Big Stone Gap, VA 24219
(888) 776-2099

www.aabakismokes.com

AabakiSmokes.com
4201 Yale Blvd NE Suite G
Albuquerque, NM 87107
(505) 344-9643

www.affordablecigs.com

Affordablecigs.com

www.americancigaretteshop.com

americancigaretteshop.com
Winston-Salem, NC

www.arrowheadsmokes.com

ArrowHeadSmokes.com
PO Box 217
Collins, NY 14034
(866) 532-0588

www.atozsmokeshop.com

AtoZSmokeShop.com
6906 W Seltice Way
Post Falls, ID
(877) 292-0009

www.awesomesmokes.safeshopper.com

Awesomesmokes.com
(866) 221-8423

www.barbisbutts.com

Barbi's Butts
6648 Rt 417
Kill Buck, NY 14748
(888) 883-3433

www.bigbd.com

Big Bear's Sales
(888) 491-8779

www.bigchiefcigarettes.com

BigChiefCigarettes.com
PO Box 645
Grundy, VA 24614
(800) 658-3711

www.bigindian.com

Big Indian Smoke Shop
1106 Rte 438
Irving, NY 14081
(800) 898-9040

www.bigsixsmokes.com

Big Six Smokes
PO Box 457
Big Stone Gap, VA 24219
(888) 776-2099

www.blackpawtobacco.com

Black Paw Tobacco
1375 Woodchuck Rd
Irving, NY 14081
(888) 860-3550 or (716) 549-7745

www.bucktowntrading.com

Bucktown Tobacco
PO Box 207
Irving, NY 14081
(888) 802-9661

www.budgetcigarettes.com

BudgetCigarettes.com
Ashland, KY
(866) 840-7158

www.bulkcigs.com

BulkCigs.com
VA

www.buydiscountcigarettes.com

BuyDiscountCigarettes.com
250 Sheep Springs Circle
Jemez Pueblo, NM 87024
(888) 437-9797

www.carolinacigarettes.com

CarolinaCigarettes.com
Winston-Salem, NC

www.cheapcigsrus.com

Cheap Cigs R Us
(888) 543-2447 or (631) 283-8047

www.cheapsmoke.com

Cheap Smoke
4340 Sanita Ct Suite F
Louisville, KY 40213
(877) 367-6653

www.cheapsmokesbymail.com

CheapSmokesbyMail.com
PO Box 28
Salamanca, NY 14779
(888) 391-1199

www.cigsmoke1.com

CigSmoke1.com
2287 S Ridgewood Ave
South Dayton, FL 32119
(386) 760-8684

www.cigarette-network.com

Cigarette Network.Com
PO Box 224
Silver Creek, NY 14136
(716) 934-2627

www.cigarettesavers.com

CigaretteSavers.com
(888) 388-1964

www.cigaretteshop.com

Nambe Tobacco Shop
PO Box 3252 Pojoaque Station
Santa Fe, NM 87501
(505) 455-0437

www.cigarettespecials.com

CigaretteSpecials.com
250 Sheep Springs Circle
Jemez Pueblo, NM 87024
(888) 437-9797

www.cigarettes4less.org

Cigarettes 4 Less
(804) 402-2100

www.cigarettesamerica.com

CigarettesAmerica.com
(888) 388-1964

www.cigarettesandtires.com

Cigarettes and Tires
PO Box 336
Salamanca, NY 14070
(866) 887-5777

www.cigarettes-and-tobacco-online.com

Cigarettes-And-Tobacco-Online.com
PO Box 376
Salamanca, NY 14779
(888) 438-8745

www.cigarettesbymail.com

eSmokes.com
PO Box 998
Lowell, NC 28098
(877) 304-1808

www.cigarettesexpress.com

CigarettesExpress.com
31 Church St
Salamanca, NY 14779
(800) 613-2447

www.cigarettesforcents.safeshopper.com

Cigarettes for Cents
(866) 221-8423

www.cigarettes-outlet.net

Cigarettes-Outlet.net
(888) 438-8745

www.cigarettesandmore.com

Cigarettes And More
PO Box 15
Versailles, NY 14168

www.cigarettesforless.com

CigarettesForLess.com
Fulton, KY 42041
(877) 865-9818

www.cigarettesonly.com

CigarettesOnly.com
1525 Cayuga Rd
Irving, NY 14081
(888) 203-7604

www.cigarettessentdirect.com

Cigarettes S.E.N.T Direct
PO Box 199
Irving, NY 14081
(800) 288-1416

www.cigarettewizard.com

CigaretteWizard.com
25 Church St
Salamanca, NY 14779
(800) 488-8555

www.cigexpress.com

cigexpress.com
PO Box 9936
Richmond, VA 23228
(804) 673-9825

www.cigmarket.com

CigMarket.com

www.cigoutlet.com

Cigoutlet.com
1303 Grumman Dr
Richmond, VA 23229
(888) 901-8901

www.cigs4cheap.com

CIGS4CHEAP.com
VA

www.cigs4free.com

Cigs4free.com
PO Box 144
Gowanda, NY 14070
(866) 244-7373

www.cigsonline.com

CigsOnline
Shelby, NC
(704) **471-1005**

www.cigtec.com

CigTec Tobacco
303 Roxbury Industrial Ct
Charles City, VA 23030
(877) 965-6694

www.classacigarettes.com

ClassACigarettes.com
PO Box 185
Gibsonville, NC 27249
(366) 449-6505 or (888) 989-3191

www.classactsmokes.com

Class Act Smokes
27 Main St
Salamanca, NY 14779
(800) 660-7114

crsmokes.com

CR Smokes
982 Route 438
Irving, NY 14081
(800) 603-3412 or (716) 549-5467

www.crazywolfsmokeshop.com

Crazy Wolf Smoke Shop
PO Box 307
Salamanca, NY 14779
(888) 282-4959

www.crocodilelounge.com

The Crocodile Lounge
PO Box 231
Versailles, NY 14168
(877) 532-1425

www.cybercigarettes.com

CigaretteSpecials.com
250 Sheep Springs Circle
Jemez Pueblo, NM 87024
(888) 437-9797

www.cycocigs.com

Cycocigs.com
4201 Yale Blvd NE Suite 6
Albuquerque, NM 87107
(505) 344-9643

www.dannystobacco.com

Danny's Tobacco.com
(888) 792-1599

www.deerpathcigs.com

deerpathcigs.com
(716) 945-1641

www.dirtcheapcig.com

dirtcheapcig.com
900 McGuire Ave Suite C
Paducah, KY 42001
(888) 808-2447

www.discountcigarette.com

Discount Cigarette Outlet
PO Box 2234
Tifton, GA 31793

www.discountcigarettescenter.com

Discount Cigarettes Center
Lexington, KY

www.discountcigarettes4u.com

DiscountCigarettes4U.com
(866) 976-6546

www.discount-tobacco.com

Discount-Tobacco.com
Fulton, KY 42041
(877) 865-9818

www.discountedcigarettes.com

discountedcigarettes.com
NC

www.drivethrusmokeshop.com

Drive Thru Smoke Shop
PO Box 7
Lewiston, NY 14092
(866) 232-2932

www.dutyfreetaxfree.com

Dutyfreetaxfree
PO Box 377
Irving, NY 14081
(877) 853-6645

www.ecig.com

ecig.com
(877) 999-3244

www.ezsmokes.biz

EZSmokes.biz
11125 Southwestern Blvd
Irving, NY 14081
(866) 766-5370 or (716) 549-1134

www.eztobacco.com

EZ Tobacco
PO Box 613
Grundy, VA 24614
(866) 398-6222

www.highlandercigarettes.com

Highlander Discount Cigarettes
370 Fair Oak St
Salamanca, NY 14779
(888) 849-9764

www.hootysapperticker.com

HootySapperTicker
(866) 466-8928

www.hot-ent.com

Honor Our Treaties Enterprises
PO Box 137
Irving, NY 14081
(888) 829-8643

www.indiansmokesonline.com

Indian Smokes Online
Salamanca, NY
(866) 840-4500

www.iroquoisconnection.com

Iroquois Connection
1567 Hare Rd
Irving, NY 14081
(877) 674-8283

www.iroquoisdirect.com

Iroquois Tobacco Direct
6665 Rt 219
Kill Buck, NY 14748
(888) 999-5509

www.joesmoke.com

JoeSmoke.com
PO Box 11
Lawtons, NY 14091
(877) 874-5252

www.keweenawbay.com

Keweenaw Bay Trading Post
PO Box 545
Baraga, MI 49908
(888) 438-8745 or (906) 524-2922

www.killbucktradingpost.com

Kill Buck Trading Post
PO Box 294
Kill Buck, NY 14748
(800) 290-3788

lasmokeshop.com

Lou Ann's Smoke Shop
PO Box 460
Collins, NY 14034
(716) 532-1181 or (877) 532-1181

www.lightupforless.safeshopper.com

LightUpForLess.com
(888) 222-8423

www.lightem-up.com

Lightem-Up Smoke Shop
(208) 237-7331

www.loneoak.net

Lone Oak.net
PO Box 224
Silver Creek, NY 14136
(888) 842-0192

www.longtrailsmokes.com

Long Trail Smokes
PO Box 1274
Lewiston, NY 14092
(877) 598-2447

www.lowcostcigarettes.com

lowcostcigarettes.com
PO Box 391
Salamanca, NY 14779
(888) 245-8807

www.nativesale.com

Native Sale.com
(800) 934-2293

www.nccigarettes.com

North Carolina Cigarettes &
Tobacco Products
178 Hood Swamp Rd
Goldsboro, NC 27534
(919) 778-1837

www.notaxsmokes.com

no tax SMOKES.com
68 Main St
Salamanca, NY 14779
(800) 532-6961

www.ojibwas.com

Ojibwas Trading Post
1358 Cayuga Rd
Irving, NY 14081
(800) 490-7999

www.otdirect.com

OT Direct.com
PO Box 246
Brant, NY 14027
(716) 337-0405

www.paiutesmokeshops.com

Las Vegas Paiute Smoke Shop
1225 North Main St
Las Vegas, NV 89101
(702) 387-6433

www.paylesscigs.com

Pay Less Cigs.com
717 West 33rd St
Richmond, VA 23225
(804) 232-3560 or (800) 828-9522

www.peacepipetobacco.com

Peace Pipe Tobacco Shoppe
22 ½ Broad St
Salamanca, NY 14779
(877) 876-6536

www.poospatuksmokeshop.com

Poospatuk Smoke Shop
NY
(877) 234-6282

www.puffnstuffonline.com

Puff'n Stuff Online
NY

www.ranchresortsmokeshop.org

Ranch Resort Smoke Shop
PO Box 92
Wyandotte, OK 74340
(877) 884-1444

www.rednationtobacco.com

Red Nation Tobacco Co.
888 ½ Broad St Ext
Salamanca, NY 14779
(877) 945-0704

www.reservationcigs.com

deerpathcigs.com
(716) 945-1641

www.rezonline.com

The Rez Online Smoke Shop
986 Bloomingdale Rd
Basom, NY 14013
(800) 468-8805

www.ronssmokeshop.com

Ron's Smoke Shop
5001 W State St
Allegany, NY 14706
(888) 280-7100

www.salamancacigaretteoutlet.com

Salamanca Cigarette Outlet
594 E State St
Salamanca, NY 14779
(888) 945-0203

www.salamancaoutlet.com

Salamanca Cigarette Outlet
594 E State St
Salamanca, NY 14779
(888) 945-0203

www.saveoncigarettes.com

Save on Cigarettes
PO Box 74035
Richmond, VA 23236
(877) 375-5987

www.senecahawk.com

Seneca Hawk Smoke Shop
PO Box 278
Irving, NY 14081
(800) 580-7116

www.senecaselecttobacco.bigstep.com

Seneca Select Tobacco
Salamanca, NY 14779
(866) 393-8058

www.senecasmokes.com

Seneca Smokes
5216 Chew Road
Sanborn, NY 14132
(877) 234-2447

www.senecasmokeshop.com

Seneca Smokeshop
PO Box 30
Irving, NY 14081
(888) 876-1935

www.senecas.com

Senecas Trading Post
1358 Cayuga Rd
Irving, NY 14081
(716) 549-8365

www.shopzmart.com

Shopzmart
VA
(877) 729-6949

www.smokesgalore.com

Smoke Signals
PO Box 246
Brant, NY 14027
(800) 272-1743

www.smokestix.com

Lazy L Tobaccos.com
NM
(877) 782-3777

smokewithus.com

Smoke With Us
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Irving, NY 14081
(800) 819-0885

www.smokemcheap.com

Smokemcheap.com
PO Box 377
Irving, NY 14081
(877) 225-5201

smokemcheapcigs.com

SmokemCheapCigs.com
PO Box 767
Basom, NY 14013
(866) 542-7141

www.smokerstation.com

Smoker Station
PO Box 236
Sanborn, NY **14132**

www.smokersden.com

Smoker's Den
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Mastic, NY 11950
(631) 395-7941 or (877) 395-7473

smokersfirst.com

smokersfirst.com
11937 Burning Springs Rd
Perrysburg, NY 14129
(800) 435-0450

www.smokesadvantage.com

Tobacco Advantage
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Louisville, KY 40299
(877) 428-3244

www.smokes-direct.com

Smokes-direct.com
12619 Shelbyville Rd
Louisville, KY 40243
(877) 297-2321 or (502) 254-9463

www.smokesoutletmall.com

SmokesOutletMall.com
PO Box 71
Versailles, NY 14168
(877) 287-7726

www.smokes-spirits.com

Cheap Smokes
501 W 11th St
Newport, KY 41071
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www.smokeysexpress.com

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(800) 535-1489

www.smokin4less.com

Smokin 4 Less
PO Box 457
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Smokin EZ
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(800) 304-8685

www.smokinturtle.com

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Collins, NY 14034
(877) 532-4414

www.stockuptobacco.com

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Steamburg, NY 14783
(888) 265-3405

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Irving, NY 14081
(877) 436-0373

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Three Feathers Tobacco
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www.tobaccojoe.com

A1Cigs.com
PO Box 36837
Albuquerque, NM 87176
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www.tobaccosource.com

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www.tobaccoxpress.com

TobaccoXpress
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Salamanca, NY 14779
(800) 634-9882

www.travelingsmoke.com

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www.twowaysmokes.com

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Irving, NY 14081
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www.valuesmokes.com

ValueSmokes.com
3350 Chadbury Dr
Concord, NC 28027

www.warpathsmokeshop.com

Warpath Smoke Shop
Nth 165 Hwy 95
Plummer, ID 83851
(208) 686-0217

www.wolfpacktobacco.com

WolfPackTobacco.com
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Salamanca, NY 14779
(800) 316-7636

www.wolfdentobacco.com

Wolf's Den Tobacco
PO Box 503
Salamanca, NY 14779
(866) 425-8182

www.wolfsrun.com

Wolf's Run
1412 Rt 438
Irving, NY 14081
(888) 532-2001

www.w2r.com/quakertradingco

Quaker Trading Co
Box 1 #1701, Route 280
Steamburg, NY 14783
(877) 945-3495

Appendix III: Comments from the Department of Justice

U.S. Department of Justice

Washington, D.C. 20530

July 22, 2002

Paul L. Jones
Director, Justice Issues
U.S. General Accounting Office
441 G Street, NW
Washington, D.C.

Dear Mr. Jones:

On July 8, 2002, the General Accounting Office (GAO) provided the Department of Justice (DOJ) copies of its draft report "INTERNET CIGARETTE SALES: Giving ATF Investigative Authority May Improve Reporting and Enforcement." The draft was reviewed by representatives of the Criminal Division, the Executive Office for United States Attorneys, and the Federal Bureau of Investigation. The DOJ is providing the enclosed minor comments for your consideration and understand that they will be incorporated as appropriate.

I hope the comments will be beneficial in completing the final document. If you have any questions concerning the Department's comments you may contact me on (202) 514-0469.

Sincerely,

Vickie L. Sloan
Director, Audit Liaison Office
Justice Management Division

Enclosure

DEPARTMENT OF JUSTICE COMMENTS
on the General Accounting Office Draft Report
"INTERNET CIGARETTE SALES: Giving ATF Investigative Authority May Improve Reporting and Enforcement"

1. Pages 3, 9, and 14. The report states that several United States Attorneys Offices (USAOs) refused requests for assistance by state authorities by declining to send letters informing internet vendors of the Jenkins Act and directing their compliance with the statute. Generally, Federal prosecutors do not issue advisory opinions about prosecutive matters, as they may subsequently be presented with the need to make an actual decision based on specific facts. The issuance of such opinions might create the basis for a legal dispute, if a subsequent prosecution were undertaken.

2. Pages 8, and 9. The report correctly notes that a Federal Grand Jury in Alaska returned a "no true bill" declining to indict in a particular case. While Rule 6(e) of the Federal Rules of Criminal Procedure bars the DOJ from discussing matters before a Grand Jury, however as a matter of public record, a Federal seizure of 1,371,000 cigarettes arising from the same matter was upheld by the 9th Circuit after a legal challenge by the seller. This seizure imposed a substantial loss on the seller.

   It is also important to note that Alaska, like other states, has a state felony law similar to the Jenkins Act, but with a much heavier penalty. While legal considerations and professional obligations preclude the DOJ from discussing the determinative facts in a particular case, a number of considerations apply to all such cases where a criminal prosecution is proposed.

   First, there must be sufficient admissible evidence to prove every element of a particular Federal offense beyond a reasonable doubt. Second, in cases where alternative means of enforcement exist, such as a state prosecution or civil or administrative enforcement, the United States Attorneys' office must consider both the most effective and efficient enforcement approach as well as the governmental entity with the greatest interest in enforcement. It must also consider competing demands for resources. These considerations, as well as other factors that must be taken into account in deciding to seek a Federal prosecution, are more fully set out in The Principles of Federal Prosecution found in section 9-27 of the United States Attorneys' Manual. Additionally, United States Attorneys' offices must consider what legal impediments and defenses might be raised in a proposed prosecution. For instance, if the potential defendant is either an Indian Tribe or the alleged violation occurred on a reservation, the potential effect of a claim of sovereignty must be considered.

3. Page 20. The GAO mentions the reluctance of USAOs to pursue misdemeanor Jenkins Act violations, but does not explore or suggest the creation of a felony offense.

Appendix IV: Comments from the Bureau of Alcohol, Tobacco and Firearms

DEPARTMENT OF THE TREASURY
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS
WASHINGTON, DC 20226

JUL 19 2002

Mr. Paul L. Jones
Director, Tax Administration and Justice
United States General Accounting Office
Washington, DC 20548

Dear Mr. Jones:

This is in response to your letter dated July 8, 2002, to Secretary Paul H. O'Neill. You forwarded a draft copy of a report entitled Internet Cigarette Sales: Giving ATF Investigative Authority May Improve Reporting and Enforcement (GAO-02-743).

The Bureau of Alcohol, Tobacco and Firearms (ATF) recommends that the report include and emphasize the need for the penalty provision of the Jenkins Act to be changed from a misdemeanor to a felony. These changes are needed to address the seriousness of the violations and to ensure that the cases are accepted for prosecution. The increased penalty would deter individuals from violating the Jenkins Act requirements and increase the likelihood of prosecution. While the report concludes that a jurisdiction change from the Federal Bureau of Investigations to ATF would result in increased enforcement of the Jenkins Act, without a concurrent increase in the penalty, U.S. Attorneys may continue to decline to prosecute the misdemeanor cases.

There are other legislative changes that might assist States in the collection of their excise taxes on cigarettes sold over the Internet. These legislative changes could parallel current laws governing or restricting the shipment of alcohol beverage products:

- The Webb-Kenyon Act, 27 USC 122, was recently amended to give States the authority to seek injunctions directly in the Federal District Court to prevent

WWW.ATF.TREAS.GOV

-2-

Mr. Paul L. Jones

businesses from shipping alcohol directly to their residents. A similar provision to amend the Jenkins Act in 15 USC 378 to allow States to enjoin violations of this Act could allow States to further prevent violations of the Act without having to rely on U.S. Attorneys;

- Under 18 USC 1716(f), individuals may not send alcoholic beverage products through the U.S. Postal Service. This provision could be amended to also prohibit the mailing of cigarettes or other tobacco products through the U.S. Postal Service; and

- For other common carriers such as Federal Express or UPS, 18 USC Chapter 59 (Sections 1261 et seq.) restricts how the carriers may ship alcohol. For instance, these provisions require bills of lading to accompany the shipment, delivery only to the consignee, and prohibit cash on delivery shipments. Common carriers violating such provisions are subject to a fine and/or imprisonment of not more than 1 year. Legislative provisions modeled after this chapter to restrict the delivery of cigarettes could include similar provisions, requirements for common carriers to notify states of their shipments, or for common carriers to obtain proof of age prior to delivery of the cigarettes.

We hope this information is helpful to you in responding to Mr. Jones. Please let me know if we can be of further assistance.

Sincerely yours,

James A. Zammillo

James A. Zammillo
Chief, Policy and Planning Staff
Office of Alcohol and Tobacco

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Washington, D.C. 20548

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PREPARED STATEMENT OF ALI DAVOUDI

Thank you, Mr. Chairman for providing me with an opportunity to respond to the testimony presented at the Subcommittee hearing held last Thursday, May 1, 2003, on HR 1839, the Youth Smoking Prevention and State Revenue Enforcement Act.

I would like to thank Representative Green and Representative Pence for taking the lead on this important issue, and the Subcommittee on beginning the debate on the important issues of preventing sales of tobacco products to minors and assuring that applicable taxes are paid to the states on tobacco sales.

My statements are submitted for the record as the President of OLTRA, Inc., the Online Tobacco Retailers Association. In 2001, OLTRA was founded by a small, concerned group of Internet tobacco retailers to bring standards of service through self-regulation to the domestic Internet tobacco industry. Over the past two years, OLTRA has grown in membership and implemented a number of policies designed to prevent the sale of tobacco products to minors through online retailers. OLTRA is committed to these measures, and to legal age verification. While OLTRA members are, for the most part, small they are not "fly-by night" operations, as asserted by the Campaign For Tobacco Free Kids.

OLTRA members sell goods, including non-tobacco products, to over one million consumers nationwide. OLTRA members actively market their products to the estimated 20% of the U.S. adult population considered to be regular smokers. We agree with NACS, that while controversial, tobacco is a legal product that is important to the economic viability of a large number of communities in the United States. OLTRA members sell tobacco products solely to adults for personal use. To this end, we employ the same precautions that are used for other age-restricted products, such as wine and beer, sold directly to consumers over the Internet.

OLTRA members are truly small businesses, embracing the entrepreneurial spirit characteristic of the United States since its foundation. OLTRA members, some of which also own local convenience stores, employ approximately 1,500 people in ten states. A significant number of OLTRA member Internet tobacco companies are businesses operated by Native American tribes in New York State and New Mexico, supporting communities on tribal land and providing jobs in communities traditionally facing high levels of unemployment. Internet tobacco retailers are also located in important tobacco-growing states such as Virginia, Tennessee, Kentucky, and North Carolina.

The online tobacco industry realizes that a perception exists that it sells tobacco to minors, fails to pay taxes, and sells contraband and counterfeit cigarettes. This perception is not true of OLTRA's members. In fact, OLTRA has worked to adopt responsible business practices, including: secure online ordering, a clearly stated refund/exchange policy, accurate product identification, clearly stated company contact information, live customer support, posted business hours, forbidding purchases made with the intent of resale, prohibiting language on websites about cigarettes being tax free or duty free, mandating a strict age verification system and imposing a requirement of sale only to adults 21 years of age and older (imposing an additional three years above the age of 18).

Because local convenience stores are bound by exclusive contracts with "Big Tobacco" manufacturers, they cannot offer consumers the same access to brands as can Internet tobacco retailers. OLTRA member retailers provide consumers with access to a wide variety of products, including those not available in local convenience stores. This gives consumers greater choice among tobacco brands, including specialty and boutique brands of tobacco products. Internet retailers also carry other consumer goods, such as rolling papers, lighters, candles, air filters, filter tips, fruit and candy, and dental products.

Internet tobacco retailers sell to a growing market of adult consumers who seek greater choice, better customer service, the convenience of direct delivery and lower prices.

THE BUSINESS MODEL OF ONLINE RETAILERS

Like other Internet retailers, OLTRA's members have adopted a business model in line with the U.S. Supreme Court's landmark decision *Quill* v. *North Dakota*, 504 U.S. 298 (1992). *Quill* held that an out-of-state seller of goods, whose only contacts with a state are by mail or common carrier, lacks the physical presence required by the Commerce Clause for the state to impose sales and use taxes upon the seller's transactions with citizens of their states. The state's imposition of such a use tax would place an unconstitutional burden on interstate commerce.

Following the lead of other retailers of age-restricted products, such as wine, and Internet businesses, like Amazon.com, eBay and Yahoo!, OLTRA members pay applicable federal and state taxes in the states in which they have a physical presence.

With over 7,600 individual taxing jurisdictions in existence, the cost of complying with each jurisdiction's tax laws would put most Internet retailers out of business. *Quill*'s bright line rule allows Internet retailers to remain in business and pay taxes to those states in which they have a physical nexus. Excise taxes are included in this bright-line rule. OLTRA members pay all federal excise taxes and applicable taxes in the states in which they are located or have a physical presence. Until the states are able to agree to simplify sales and use taxes and ease the collection and remission of sales taxes by out-of-state retailers, the rule set forth in Quill applies.

Requiring the retailers to collect and remit taxes to the states would change the Quill standard for one particular type of product—cigarettes. No other product, age-restricted or non-age-restricted, would face the same change. Cigarettes should be treated like all other products. Congress should not change the *Quill* standard for cigarettes unless it also changes the standard for books, music, clothing, wine and other legal products.

OLTRA members support a uniform nationwide system for all Internet, telephone, and mail order retailers to collect and remit applicable taxes directly to state taxing authorities. Such a uniform system, currently being addressed by the Streamlined Sales Tax Project, would be vastly more efficient as a means of tax collection than an ad hoc, piecemeal approach targeting a single type of consumer product.

HR 1839 would not be uniform, efficient, or effective. It is not uniform because it would exacerbate the disparate treatment of Internet tobacco retailers. It would compel them, unlike all other interstate retailers, to participate in the tax collection process. Giving individual states the authority to bring actions against retailers would lead to a patchwork of different enforcement decisions in each state. There is no rational basis for this unequal treatment.

It would impose upon them the duplicative burden of filing reports under the Jenkins Act, and would do so upon the heightened threat of felony penalties. Such penalties are not imposed on other retailers. The imposition of criminal penalties would be excessive, and sanctions should be no greater than penalties for violation of FTC regulations governing the sale of consumer goods.

It is difficult to conceive of a less efficient means of tax collection than reporting sales in the hope that sums can later be collected from consumers. Such an approach increases the costs of collection, as each state, no matter how strained its budget, would have to invest in person-by-person collection of taxes on a few cartons of cigarettes at a time. Moreover, since no other sales of products across state lines are subject to this reporting and collection process, each state will have to hire ad hoc tax collectors to carry out this cumbersome program. The efficiencies that come from point-of-sale tax collection, and the attendant benefits to the States, would be lost.

Turning over personal information to the states would raise significant privacy concerns. The states do not store consumer information in a secure or adequate manner. According to an article published in the March 26, 2003 edition of *The Washington Post*, "only 14 states, including Virginia, comply with federal mandates to help ensure the protection of computer systems that hold confidential information about millions of people."

The penalties proposed by groups such as the Campaign for Tobacco Free Kids would not stop the sale of tobacco products over the Internet. It would end the sale of these products by responsible retailers, like OLTRA's members, and leave the door open to "fly-by night Internet retailers," smuggling operations, foreign retailers and organized crime. It should be apparent that a uniform nationwide system for point-of-sale tax collection is a far better and more efficient means of collecting taxes.

HR 1839 as drafted is also ineffective because it will not have the effect of collecting more tax revenues for the states. The Act does nothing to overcome the problems inherent in the outdated process of reporting and collecting in each state. Increasing the penalties would in fact be counterproductive, because it will have the effect of banning the sale of tobacco products to adult consumers over the Internet. In fact, it would drive consumers to seek out contraband and illegitimate tobacco products, once responsible retailers are put out of business. See Patrick Fleenor's Cato Institute Policy Analysis No. 468, "Cigarette Taxes, Black Markets and Crime: Lessons From New York's 50 Year Losing Battle," published February 6, 2003. Another recent study, published by the Beacon Hill Institute at Suffolk University, states clearly that New York City's tobacco tax increase "will generate less than half the revenue projected by New York City and will result in a net loss approaching $217 million."

Therefore, considerations of equality, efficiency and effectiveness warrant study and implementation of a point-of-sale means of tax collection, applicable to all retail-

ers under a uniform national system mandated by Congress. Any effort to address this issue should be consistent with such an approach.

EFFORTS TO PREVENT SALES TO MINORS

OLTRA agrees with NACS that minors should not have access to tobacco and that no retailer should sell tobacco products to minors. OLTRA believes, however, that it is much further along in its efforts to prevent tobacco sales to minors than efforts by local convenience stores. While Mr. Armour's stores may have adopted measures to prevent sales to minors, there are 133,976 other convenience stores across the country (and probably a large number of other stores that sell tobacco products). A large percentage of these stores employ workers who more often than not do not verify that a tobacco purchaser is at least 18 years of age.

One recent example of the ease with which minors can purchase tobacco products from convenience stores occurred in Massachusetts. As reported in the *Boston Globe* on May 1, 2003, "the number of stores illegally selling cigarettes to teenagers in Massachusetts more than tripled in the past year, after budget cuts forced health boards across the state to abandon their local inspection programs."

The Massachusetts Association of Health Boards *(www.mahb.org)* conducted an elaborate sting operation where minors, under adult supervision, attempted to purchase cigarettes in local stores in 68 Massachusetts cities and towns. In 2002, the average rate of illegal sales to minors in these towns was 9.3%. When these same locations were checked in February-April 2003, the average rate of illegal sales more than tripled to 29%. Teens visited 221 stores, and were able to purchase a pack of Marlboros from 64 of those retailers. According to Cheryl Sbarra, Director of the Tobacco Control Program for MAHB, "Massachusetts has not seen the illegal sales to minors rate this high since 1995. It is more than twice the national average."

While Mr. Armour's stores may have only had 4 instances of sales to minors out of several million transactions last year, these figures do not demonstrate the number of minors that did not participate in a sting sale or were not caught. His figures do not demonstrate that local convenience stores are preventing the sale of tobacco products to minors at a higher rate than OLTRA's members.

In contrast with the frequency of cigarette sales to minors by local convenience stores, minors face a number of barriers if they make similar attempts to purchase tobacco products from Internet retailers.

The effectiveness of such measures can be empirically demonstrated. There is little evidence of minors purchasing tobacco products on the Internet. This is due to cost of the product, the cost of shipping, the required use of credit cards, the time taken for delivery, and the risk of parental detection, all of which discourages minors from purchasing from online sources. Minors tend to purchase tobacco products from social sources or in local convenience stores in pack form, and not in cartons from Internet retailers, who have minimum sale requirements of one carton or more.

OLTRA has instituted a policy mandating that its members only sell tobacco products to individuals 21 years of age or older, and that its customers receive the products they purchase through either the United Parcel Service age verification system or United States Postal Service restricted delivery system.

Under the UPS system, a package cannot be delivered to a consumer until an adult signature is received by a UPS driver. When this method of shipment is used, UPS will not leave the package at the customer's doorstep or with a neighbor. The UPS driver cannot release the package or clear the delivery from his handheld monitor until he has verified that the recipient is an adult. The UPS driver will ask to see a government issued photo identification card, verifying that the recipient is at least 21 years of age. UPS will not deliver a package to anyone under the age of 21. Once the package is delivered, a confirmation of delivery is sent to the retailer. This is the same system used successfully by the Wine Industry.

When USPS Restricted Delivery is used, Postal delivery drivers must check the recipient's identification before a package is tendered to a recipient. The Postal delivery driver cannot leave the package at the door of the customer or with a neighbor. A package sent by Restricted Delivery can only be delivered to the customer whose name is on file with the local Post Office (if a spouse is on file with the Post Office, the spouse can sign for the package).

The Postal delivery driver must collect the signature of the recipient. Once the package has been delivered, a confirmation is sent to the retailer containing the name of the recipient. A retailer can also request that a copy of the recipient's signature be sent to the retailer by facsimile or e-mail.

While packages sent USPS Restricted Delivery can be delivered to business addresses, packages can only be delivered and signed for by the recipient or his au-

thorized agent (described above). USPS will not deliver a package to an individual who is not authorized to receive it. This is done so that the Postal delivery driver can check the age and identity of the recipient and verify that the recipient is of legal age.

OLTRA has adopted the following measures to prevent the sale of tobacco products to minors from member websites:

- Requiring each purchaser to create an account to purchase tobacco products.
- On all new accounts, consumers must submit accurate name, age, address, credit card, and billing information, along with a copy of a government-issued photo ID.
- Checking credit card information against an address verification system to prevent fraud.
- Publishing clear statements that the sale of tobacco products to individuals 21 years of age or under is prohibited.
- Selling only to adults 21 years of age or older.
- Notifying purchasers that it is a crime for individuals under the age of 18 to purchase cigarettes.
- Notifying purchasers that their tobacco products are for personal use only and not for resale.
- Refusing to sell tobacco products to any purchaser who does not provide accurate information.
- Using the UPS Age Verification System for all first-time deliveries on new accounts (or USPS restricted delivery). UPS drivers must obtain an adult signature and the recipient must present a photo ID to the driver proving that the recipient is of legal age to accept tobacco products, if the recipient appears to be under the age of 27. This is the same system used to deliver other age-restricted products, including wine.
- Placing prominent disclaimers on all websites stating that OLTRA members do not sell to minors.
- Placing all required Federal warnings on member websites.

Members have taken individual steps to employ further verification tools through third-party software, which checks consumer information against a variety of government, credit reporting, DMV and other databases. Several members have also registered with NetNanny and similar services, companies that produce software allowing parents to select which websites should be blocked from the view of their minor children on their own home computers.

There are retailers, both online and brick and mortar, that do not verify the age of their purchasers. These retailers are not OLTRA members. OLTRA reviews the websites of its members, and if a website is not in compliance with the OLTRA standards, it will be removed from the organization.

OLTRA believes that the only way to resolve age verification issues on Internet sales of tobacco products is through the adoption of national standards through federal legislation, not through a patchwork of regulations by the individual states. OLTRA would support a federal standard on age verification, similar to those currently utilized by OLTRA members, to minimize the sale of tobacco products to minors, as long as those procedures are economically viable and do not interfere with the significant benefits of purchasing over the Internet (secure ordering, better customer service, convenient and fast delivery and greater consumer choice).

ENFORCEMENT BY STATE ATTORNEYS GENERAL

OLTRA opposes the provision in HR 1839 which would grant to State Attorneys General the authority to bring actions against Internet retailers in federal court for violations of state and federal law. OLTRA is in favor of national standards and national enforcement. Retaining enforcement with the federal government and not the states ensures a consistent body of law. Enforcement authority should remain with the federal government, rather than permit a variety of results based on the application of conflicting laws that vary from state to state.

APPLICATION TO NATIVE AMERICAN RETAILERS

A number of OLTRA members are Native American retailers located on tribal land. These retailers provide jobs in their communities, employing Native Americans, adding a technological infrastructure in areas previously burdened with high unemployment and lacking in high tech jobs.

Native American retailers make up the largest percentage of Internet tobacco businesses. This statistic was evident in the GAO Report, which listed 87 of the 147 Internet tobacco websites as being on Native American land.

HR 1839 would end the sale of cigarettes from Native American retailers to non-tribe members and the passage of HR 1839 would expose Native American retailers to individual state laws, laws that do not now apply to Native American retailers because they would violate their sovereign rights, the Indian Commerce Clause and the Supremacy Clause of the United States Constitution.

For example, as a sovereign Native American nation, the Seneca Nation and its members are immune from suits brought by any state. New York State has recognized that the Seneca Nation and its members have sovereign immunity. In 1997, Governor Pataki stated, "we respect your sovereignty and, if the Legislature acts as I am requesting, you will have the right to sell tax-free gasoline and cigarettes *free from interference from New York State*" (emphasis added). See *Santa Fe Natural Tobacco Co., Inc.* v. *Spitzer*, Nos. 00 Civ. 7274 (LAP), 00 Civ. 7750 (LAP), 2001 U.S. Dist. LEXIS 7548, 2001 WL 636441 (S.D.N.Y. June 8, 2001). This is particularly troubling in New York State, where the price of cigarettes has risen dramatically over the past year. As recently as May 3, 2003, New York Governor George Pataki stated that imposing state taxes on Native American retailers "would be extremely unrealistic."

This Subcommittee should work closely with OLTRA to ensure that tribal groups are able to have input into consideration of this bill, which will have a significant impact on the economies of Native American tribes that sell tobacco products over the Internet.

CONFLICTS WITH OTHER BILLS

HR 1839, and other bills that may be introduced to regulate the sale of tobacco products over the Internet, may conflict with legislation currently under consideration.

Four bills have been introduced on Internet tax issues, three would make permanent the Internet Tax Freedom Act ("ITFA") first passed in 1998 and extended in 2001. The IFTA expires on November 1, 2003.

- HR 49, introduced by Representative Chris Cox, has 112 co-sponsors. On April 1, 2003, the House Subcommittee on Commercial and Administrative Law held a hearing on the bill. Testifying in support were: Hon. James Gilmore III, former Governor of Virginia, former Senator Jack Kemp (Director of Empower America), and Harris Miller, President of the Information Technology Association of America (ITAA).

  Gilmore, a supporter of the original Internet Tax Moratorium passed in 1998, testified in support of federal codification of a "bright-line" nexus standard in line with the U.S. Supreme Court's *Quill* decision. According to Gilmore,

  > The cyber economy has blurred the application of many legal nexus rules. American businesses need clear and uniform tax rules. Therefore, Congress should codify nexus standards for sales taxes in a way that adapts the law of nexus to the New Economy and the new "dot com" business model. Codification of nexus would serve several important policy objectives: (1) provide businesses "bright line" rules in an otherwise confusing system of state-by-state nexus rules; (2) protect businesses, especially small businesses, from onerous tax collection burdens; (3) reduce the amount of costly litigation spurred by confusing nexus rules; (4) nurture the full growth and development of electronic commerce; and (5) give consumers and individual taxpayers who participate in Internet commerce a tax break.

  Kemp agreed with Gilmore, and also cited to the *Quill* decision in his testimony before the House Subcommittee. Kemp stated that "The central issue in the Internet tax debate is not 'fairness' as the NGA and some others would have us believe; **it is taxation without representation**. States have been trying for more than three decades to tax people and businesses that are located out-of-state because politicians are acutely aware non-residents can't vote them out of office."

  The final speaker, Harris Miller, testifed that "The Internet does not deserve carve outs or special treatment. Neither does it deserve to become the tax piñata of 2003, hit by every revenue starved taxing jurisdiction in the country." Miller discussed his support for the *Quill* decision, stating that the "ITAA believes that the states must simplify their tax systems and provide

bright line business activity tax nexus standards before seeking the authority to require remote sellers to collect sales tax on their behalf."

- S. 150, introduced by Senator George Allen of Virginia and seven other co-sponsors. Senator Allen has been a strong supporter of efforts to remove barriers to free trade over the Internet.
- S. 52, introduced by Senator Ron Wyden of Oregon and two other co-sponsors. Senator Wyden was an original sponsor of the Internet Tax Freedom Act in 1998.
- HR 1481, introduced by Representative Zoe Lofgren of California. This bill would extend the Internet tax moratorium to 2008.

These bills, and their wide support in the House and Senate, demonstrate that the jurisdictional issue should be addressed for the sale of all products, not only tobacco.

HR 945, introduced by Representative Cliff Stearns, and four co-sponsors, would exercise authority under the Commerce Clause to clearly establish jurisdictional boundaries over the commercial transactions of digital goods and services conducted through the Internet, and to foster stability and certainty over the treatment of such transactions. HR 945 would give the federal government, not the states, authority to regulate commerce in digital goods and services. If the federal government can assert authority over digital goods and services, why not apply this same standard equally to all goods?

Finally, HR 1636, introduced by Representative Cliff Stearns and twenty-two other co-sponsors, would protect and enhance consumer privacy over the Internet. The bill would preempt "any statutory law, common law, rule, or regulation of a State, or a political subdivision of a State, to the extent such law, rule, or regulation relates to or affects the collection, use, sale, disclosure, retention, or dissemination of personally identifiable information in commerce. No State, or political subdivision of a State, may take any action to enforce this title." This legislation could be interpreted as superseding state laws calling for the submission of confidential customer data to state taxing authorities.

SUMMARY

I look forward to working with the Subcommittee to craft a bill that will deal reasonably with these vital issues.

OLTRA has adopted strict age verification policies and business standards for its members. It supports efforts to prevent the sale of tobacco products to minors. OLTRA supports the uniform enforcement of federal law by federal agencies, rather than giving State Attorneys General the power to bring an action in federal courts.

OLTRA's members in starting their businesses adopted a business model in line with the *Quill* decision, paying all federal excise taxes and applicable state taxes in the states in which member retailers are located or have a presence. OLTRA's members, except for some of its Native American members, support efforts that would establish uniform standards for the collection and remission of applicable taxes to the states on all products, not just tobacco.

I hope that these statements are helpful to the Subcommittee and I stand ready to testify before the Committee if asked.

ATTACHMENT

OLTRA STANDARDS

1. Secure online ordering

2. A clearly stated refund/exchange policy

3. Customer information kept confidential - incorporate acceptable business standards with respect to protecting customer information

4. Accurate product identification

5. Clearly stated company contact information

6. Live customer support

7. Business hours listed on the site

8. Approved age verification system
   A. On 1st orders – Mandatory Adult Signature
   B. Date of Birth on all orders
   C. Pop-up somewhere on the site or entry page that requires the person to affirm that they are at least 21 years of age before they may purchase.
   D. We ***recommend*** an electronic age verification system in addition to the above three mandates.***

9. OLTRA member companies must include the following statement on their websites: "All applicable Federal taxes have been paid." No language on the site about the cigarettes being tax-free, duty-free….No language or reference whatsoever to not reporting customer information to government agencies. Language regarding the privacy of the customer's information is permissible. OLTRA members are free to use the following language which states that "we have paid the taxes in the states where the purchase is consummated and that {consumer} should check with their own taxing authorities to determine their additional tax liability, if any, as the burden of payment, if any, falls on the consumer."

10. OLTRA members forbid purchases made with the intent for resale. Only sales to consumers for their own personal use will be permitted. Member companies must include Language stating "These tobacco products are for personal consumption only and by completing this transaction, you agree that these tobacco products are not for resale" on the site.

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