SENATE No. 2215

The Commonwealth of Massachusetts

LEGISLATIVE RESEARCH COUNCIL

Report Relative to

CIGARETTE BOOTLEGGING

For Summary, See Text in Bold Face Type

77167

April 16, 1980.

77167

The Commonwealth of Massachusetts

ORDER AUTHORIZING STUDY

(Senate, No. 1661 of 1979)

Ordered, That the Legislative Research Council is hereby authorized and directed to make a study and investigation relative to the laws, practices and procedures of Massachusetts and other states for the prevention of the "bootlegging" of cigarettes and other tobacco products; and that the said council shall file its statistical and factual report hereunder with the Clerk of the Senate not later than the last Wednesday of February in the year nineteen hundred and eighty.

Adopted:
By the Senate, May 15, 1979
By the House of Representatives, in concurrence, May 16, 1979

(Unnumbered House Order of 1980)

Ordered, That the time be extended to the last Wednesday of March in the current year whereby the Legislative Research Council is required to report its study and investigation relative to "bootlegging" of cigarettes and related tax avoidance (see Senate, No. 1661 of 1979).

Adopted:
By the House of Representatives, February 26, 1980
By the Senate, in concurrence, February 28, 1980

(Unnumbered Senate Order of 1980)

Ordered, That the time be extended to the third Wednesday of April in the current year whereby the Legislative Research Council is required to report on its study of the laws, practices, and procedures of Massachusetts and other states for the prevention of the "bootlegging" of cigarettes and other tobacco products (see Senate, No. 1661 of 1979 and unnumbered House Order of February 26, 1980).

Adopted:
By the Senate, April 3, 1980
By the House of Representatives, in concurrence, April 7, 1980

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LETTER OF TRANSMITTAL TO THE SENATE AND HOUSE OF REPRESENTATIVES

To the Honorable Senate and House of Representatives:

Ladies and Gentlemen: — In compliance with the legislative directive in Senate, No. 1661 of 1979, the Legislative Research Council submits herewith a report prepared by the Legislative Research Bureau relative to cigarette tax evasion.

The Legislative Research Bureau is restricted by statute to "statistical research and fact-finding." Hence, this report contains only factual material without recommendations or legislative proposals by that Bureau. It does not necessarily reflect the opinions of the undersigned members of the Legislative Research Council.

Respectfully submitted,

MEMBERS OF THE
LEGISLATIVE RESEARCH COUNCIL

SEN. ANNA P. BUCKLEY of Plymouth, *Chairman*
REP. MICHAEL J. LOMBARDI of Cambridge, *House Chairman*
SEN. JOSEPH B. WALSH of Suffolk
SEN. JOHN F. PARKER of Bristol
SEN. ROBERT A. HALL of Worcester
REP. ARTHUR M. KHOURY of Lawrence
REP. WILLIAM P. NAGLE, JR. of Northampton
REP. WILLIAM Q. MACLEAN, JR. of Fairhaven
REP. IRIS K. HOLLAND of Longmeadow
REP. SHERMAN W. SALTMARSH, JR. of Winchester
REP. BRUCE N. FREEMAN of Chelmsford
REP. CHARLES N. DECAS of Wareham

The Commonwealth of Massachusetts

LETTER OF TRANSMITTAL TO THE LEGISLATIVE RESEARCH COUNCIL

To the Members of the Legislative Research Council:

Ladies and Gentlemen: — Senate, No. 1661 of 1979, reprinted on the inside front cover, directed the Legislative Research Council to investigate and study the practices and procedures of Massachusetts and other states for the prevention of the bootlegging of cigarettes and other tobacco products.

The Legislative Research Bureau submits herewith such a report. Its scope and content have been determined by statutory provisions which limit Bureau output to factual reports without recommendations. The preparation of this report was the primary responsibility of Charles R. Ring of the Bureau staff.

Respectfully submitted,

Daniel M. O'Sullivan, *Director*
Legislative Research Bureau

The Commonwealth of Massachusetts

CIGARETTE BOOTLEGGING

SUMMARY OF REPORT

Economic Impact of the Tobacco Industry

In 1977, the American public spent approximately $17 billion on tobacco products, $16 billion of which was for cigarettes. This $17 billion expenditure accounted for $1.00 out of every $75 of all retail expenditures and $1.00 out of every $27 spent on nondurable consumer goods. When the effects of both personal and capital expenditures are multiplied throughout the economy, an additional $23.1 billion in consumption spending and $13.7 billion in capital investments are attributable to the tobacco industry.

A major agricultural commodity, tobacco, is grown on approximately 276,000 farms in 18 states, including the Connecticut Valley area in Massachusetts where "shade tobacco," the cigar binder and wrapper type, is produced. Cigarette-type tobacco production is concentrated in North Carolina, South Carolina, Virginia, Florida, Kentucky, and Tennessee. In 1977, tobacco farming provided employment for 124,000 persons, whose total compensation amounted to $522 million. The high return per acre and the ability to utilize family labor has made tobacco one of the few crops which can still provide an adequate income on a small family farm. The manufacture of tobacco products is another element of its economic importance and in 1977 provided employment for approximately 80,000 persons. Wholesale and retail distribution of tobacco products provided an additional 200,000 jobs with a payroll of approximately $2 billion.

Cigarette Taxation

The final element of tobacco's economic impact, and the one that led to the problems discussed in this report, is taxation. Cigarettes are currently taxed by the federal government, all 50 states, the District of Columbia, and numerous local governments. Twenty states also tax other tobacco products. In 1979, federal, state, county, and city excise taxes on cigarettes totaled in excess of $6

billion or approximaely $28 for every man, woman, and child in the United States. Depending upon his/her state of residence, a pack a day smoker pays from $40.16 to $116.80 a year in taxes.

Cigarettes have been subject to taxation since the federal government first imposed an excise tax of 0.8c per pack of 20 cigarettes on June 20, 1864. Federal tax revenue has grown from $15,000 in 1865 to about $2.4 billion in 1979. While federal tobacco tax revenue has increased dramatically in absolute terms, its relative contribution to total federal revenue has shown a marked decline. Its contribution peaked at 11.4 percent between 1931 and 1940, and declined precipitously thereafter. The $2.4 billion raised by federal tobacco taxes in 1979 represented only 0.5 percent of total federal tax collections.

The present federal tax of 8c per pack was set in 1951. Arguments in favor of increasing the federal excise have taken two forms. First, it is argued that the present rate is unrealistic in the light of recent inflationary trends. Proponents of this view point out that 8c in 1951 is the equivalent of 20c today, and that the federal excise tax represents only one-seventh of the cost price of a pack of cigarettes compared to one-third of the average price in 1951. Other advocates contend that higher cigarette levies will discourage consumption and could be used to shift the medical costs of smoking from the general public to the smoker.

The first state cigarette tax was enacted by Iowa in 1921 at a rate of 2c per pack. Massachusetts enacted its first temporary cigarette levy in 1939. North Carolina became the 50th state to enact a cigarette tax, passing its present levy of 2c in 1969. In addition to becoming more widespread, cigarette taxes have been assessed at increasing rates over the years. With the exception of North Carolina, every state has increased its tax rate since it was first initiated. While the nonproducing states increased their taxes to provide for marginal funding needs and to discourage consumption, the producing states have maintained low rates of taxation. The resulting tax disparities made it profitable to transport cigarettes between states, and gave rise to cigarette bootlegging. Growing numbers of smokers in the high tax states sought to reduce their costs by purchasing cigarettes in neighboring states or by stocking up in the more distant producing states.

The emergence of this market created a situation which made it profitable to transport large quantities of cigarettes between states for illegal resale. Over time, the magnitude of cigarette tax evasion grew, and presently such activities constitute a major cause of lost tax revenue for many states.

Cigarette Tax Evasion

Cigarette tax evasion is generally divided into four distinct categories: (1) casual smuggling, (2) organized smuggling, (3) mail order purchase, and (4) purchases through tax-free outlets. The magnitude of the problem represented by any of these methods varies by state.

Casual smuggling is committed by the individual from a high tax state who travels to a low tax state to purchase cigarettes for himself and his friends. So long as no profit is realized, it remains casual smuggling. Because of its 21c per pack tax levy, Massachusetts presents an ideal environment for casual cigarette smuggling. Its tax rate exceeds that of five of the six states to which it is contiguous. With disparities ranging from 90c per carton for New Hampshire and Vermont to 30c per carton for Rhode Island, Connecticut is the only bordering state with an equivalent tax rate and it has been restrained in its efforts to raise the tax still further by growing evidence of a serious cigarette smuggling problem. Long borders, an excellent interstate highway system, frequent visits to neighboring states by Massachusetts residents, and limited tax enforcement are factors which tend to indicate that a significant amount of casual smuggling is occurring in the Commonwealth. More positive support for the contention that a significant proportion of Massachusetts cigarette tax losses is attributable to casual smuggling is provided by a comparison of changes in Massachusetts per capita sales with changes occurring in the bordering states. Such a comparison clearly shows that declines in Massachusetts per capita sales following the imposition of higher cigarette excise taxes have consistently been matched by significant increases in New Hampshire's per capita sales. Although Vermont has always ranked higher in per capita sales than would be expected in the light of the state's demographic characteristics, cigarette purchases by non-residents appear to have increased since 1971. Further evidence of significant levels of casual smuggling is provided by the observation of two large Massachusetts wholesalers who have stated that New Hampshire retail establishments located in close proximity to the Massachusetts border sell ten times as many cigarettes as their counterparts within Massachusetts. Although casual smuggling deprives the affected state of revenue just as surely as any other form of tax evasion, this form of cigarette smuggling has not elicited as much concern as its other varieties. With the exception of tax administrators and some law enforcement personnel, most people view such activities as a relatively benign form of tax evasion.

Organized smuggling is the routine transportation of cigarettes between states for illegal resale. Organized smuggling began with the small time entrepreneur who traveled to a low tax state and purchased a relatively large quantity of cigarettes for eventual resale in his home state. As these operations became more extensive and profitable, organized crime elements were attracted. Cigarette smuggling was ideally suited for organized crime involvement. By purchasing and transporting large quantities of cigarettes at a single time, large scale operators could reduce costs and increase profits. Small time operators could be driven out or curtailed, and monopoly markets established through the use of intimidation and force. The enforcement efforts of the states were small and uncoordinated and no federal enforcement agency had jurisdiction applying to illegal over-the-road transportation of untaxed cigarettes. The low level of fines and lack of prison sentences in past cases offered little in the way of a deterrent. In addition, expanded enforcement efforts against organized crime's more traditional sources of revenue (i.e., narcotics, extortion, counterfeiting, etc.) necessitated new revenue sources.

The extent of organized crime's involvement in cigarette smuggling is undetermined. Evidence indicates that organized criminal enterprises are operating in several midwestern states (Ill., Ind., Mich., Minn., and Ohio). Organized crime families have attained a virtual monopoly over cigarette bootlegging in New York City and are also very active in Connecticut, Florida, New Jersey, and Pennsylvania. The current involvement of organized crime in cigarette smuggling operations in Massachusetts is uncertain. Although past estimates by state officials have attributed as much

as 50 percent of the state's losses to organized crime involvement, evidence to support this contention is sparse.

A third category of cigarette tax evasion is the use of the mails to transport cigarettes between states for the purpose of avoiding the destination state's tax. The federal government regulates such sales through the Jenkins Act. During the most recent Congressional hearings, the consensus of opinion was that the magnitude of such practice has declined in recent years. Massachusetts enforcement officials concur with this belief.

A fourth method by which untaxed cigarettes are obtained is purchase through tax-free outlets. International points of entry, Indian reservations, and military post exchanges are the primary sources of such purchases. Problems arising from the first of these channels are concentrated in those states in close proximity to the Mexican border. Tax-free cigarette sales on Indian reservations to non-Indians are a major problem in five western states (Ida., Mont., Nev., N.M., and Wash.). Purchases of state tax-free cigarettes by active duty military personnel and other qualified parties, while depriving the state of its excise revenue, cannot be termed tax evasion. Because such transactions occur in places having the legal status of federal instrumentalities, they are immune from state and local taxes unless Congress specifically authorizes the imposition of such taxes. The extent of illegal purchases and resale of cigarettes from military and other federal outlets is unknown. The Massachusetts Department of Revenue has estimated that the state lost almost $7 million in 1979 as a result of the exemption of cigarettes sold on military bases from state taxation. The Department has attempted to curtail the illegal resale of cigarettes purchased through military outlets by requesting that such sales be limited to two cartons per person per week. However, the Department has not received any acknowledgement of its request from military officials and has no knowledge regarding the extent to which this policy is being complied with.

Revenue Losses

The Department of Revenue's most recent estimate of the revenue losses being experienced by the state from cigarette bootlegging is $12 million. The Legislative Research Bureau has estimated the 1979 revenue loss at approximately $17 million. This translates into approximately eight million cartons of cigarettes which were consumed by Massachusetts residents and upon which the state excise had not been paid. According to a recent update by the Bureau of Alcohol, Tobacco and Firearms (ATF) of estimates included in a 1975 ACIR study, the Bay State experienced a loss of $20.8 million. Only four states experienced losses in excess of that figure in 1979.

Federal Legislation

Both state and federal enforcement officials are hopeful that a 1978 federal law will curtail cigarette bootlegging. Other sources, particularly officials in the producing and low tax states, contend that the illicit traffic can be eliminated only by (a) reduced cigarette tax rate disparities among the states, (b) greater enforcement by the states, (c) stringent state penal sanctions for bootleggers, and (d) interstate cooperation. Public Law 95-575 defines the term "contraband cigarettes" as a quantity of more than 60,000 cigarettes (300 cartons) which bear no evidence of the applicable state excise tax having been paid. Although the legislation authorized the Secretary of the Treasury to require certain records pertaining to the disposition of quantities of cigarettes in excess of 300 cartons in a single transaction, no Treasury regulations governing such transactions have been adopted.

The maximum penalty for conviction of "the possession of, or trafficking in, contraband cigarettes" is a $100,000 fine or five years in prison, or both. Violators of the record-keeping requirements are subject to a fine of up to $5,000 and imprisonment of three years. Although the law authorizes the ATF to seize contraband cigarettes and the vehicles used to transport them, the Bureau's policy has been to allow state enforcement agents to take possession when authorized to do so by state statutes. Known as the "split seizure concept," this practice allows the states to sell the cigarettes and vehicles to recoup a portion of the lost tax revenues.

Because of its recent origin, the effectiveness of the federal "contraband" law cannot be determined. Between October 1, 1978 and September 30, 1979, the ATF expended 17,082 man-days on the enforcement of the federal law. ATF agents participated in the arrests of 29 individuals who were charged with violations of the

federal statute. Joint operations by ATF, state, and local authorities resulted in the seizure of 26,075 cartons of contraband cigarettes and the confiscation of 15 motor vehicles. The average size of the seizures was approximately 1,185 cartons.

Massachusetts Enforcement

Responsibility for the administration, collection, and enforcement of the Massachusetts cigarette tax is vested in the Department of Revenue. Prior to 1976, the Department devoted limited resources, manpower, and effort to the investigation of cigarette bootlegging in Massachusetts. Three tax administrators, none of whom had any formal training or practical experience in criminal investigations, were assigned this function, in addition to their administrative duties, collection duties, and other responsibilities. In 1975, Massachusetts revenue agents in conjunction with local and state police arrested four persons for offenses related to cigarette smuggling. A total of 3,000 cartons of contraband cigarettes were seized. According to the ACIR, almost 6,000,000 cartons of cigarettes, on which the Massachusetts excise tax had not been paid, were consumed by Massachusetts residents in 1975.

In November of 1975, the Attorney General joined with the Department of Revenue in a joint effort against cigarette smuggling in Massachusetts. By April of 1977, when this formal program of joint investigations was terminated, 20 individuals had been arrested and convicted of some form of cigarette tax evasion. Generally, the defendants received minor fines; none received prison terms. Seven vehicles were seized, three of which were ultimately forfeited to the state. Five thousand cartons of contraband cigarettes were impounded and, when sold, realized $12,500, which was paid to the General Fund. Persons involved in the investigations estimate that these efforts eliminated smuggling operations which were costing the state $1 million in lost revenue and generating $600,000 in illegal profits.

No records exist relative to the number of investigations, arrests, or seizures which occurred during the next 26 months. In July of 1979, the enforcement efforts of the Department of Revenue were reorganized and assigned to a special unit, the Cigarette Enforcement Unit, within the Department's Special Intelligence Bureau. This section currently consists of one supervisor, five investigators, and one secretarial position. As of March 1, 1980, this unit has conducted 14 investigations resulting in either state or federal prosecution of 17 individuals. Three vehicles have been seized and 1,850 cartons of cigarettes confiscated. Twelve of these investigations were conducted either jointly or with the cooperation of the ATF. On March 20, 1980, the Massachusetts Department of Revenue and the ATF completed a six-month investigation of a cigarette stamp counterfeiting ring, which resulted in the seizure of approximately 1,500 cartons of contraband cigarettes. These cartons bore either counterfeit Massachusetts tax stamps or legitimate North Carolina stamps. Also seized were a counterfeit tax stamping device, several cigarette vending machines, money, and a large quantity of narcotics. This operation was known to have existed for over two years and is estimated to have been costing the Commonwealth in excess of $150,000 per year in lost cigarette tax revenue.

Legislative Proposals

State enforcement officials point to several factors which have inhibited past efforts to control cigarette bootlegging in the Commonwealth, namely, (1) the leniency of current criminal sanctions and the attitude of the judiciary toward offenders, (2) the absence of arrest powers, and (3) the lack of a radio communications system, automobiles, and surveillance equipment. To enhance its ability to address the problems posed by cigarette smuggling, the Department of Revenue has filed legislation seeking to increase the statutory penalty for transporting, possessing or selling unstamped cigarettes, or cigarettes upon which the Massachuetts tax has not been paid. House, No. 250 of 1980 seeks to amend Section 34 of Chapter 64 of the General Laws to provide for a maximum fine of $5,000 and imprisonment for not more than five years, or both, for unauthorized individuals found to be in possession of, with intent to sell, more than 60 cartons of contraband cigarettes. Where the violation involves less than 60 cartons, the accused would be subject to a fine of not more than $1,000 or to imprisonment for not more than one year, or both. Support for this change is based upon a belief that the current penalties do not reflect the seriousness of the offense and allow smugglers to increase their volume without any corresponding increase in risk. Further, such a change will act as a stronger deterrent to such activities without any additional cost. The proposed legislation would also amend Sections 50 to 54 of G.L. c. 140 to allow the Commissioner of Revenue to conduct the sale of confiscated cigarettes, vending machines, receptacles, and/or vehicles seized from convicted persons. Present law vests such power in the Commissioner of Public Safety.

Other areas in which some members of the Department of Revenue have expressed interest are: (1) the use of informer fees; (2) the establishment of a toll-free "hot-line"; (3) eliminating the need for a court hearing prior to disposal of confiscated cigarettes; (4) the retention by the Cigarette Enforcement Unit of one-half of the proceeds realized from such sales; (5) the use of public interest media time to alert the public to the seriousness of cigarette smuggling activities; and (6) increasing industry involvement in uncovering illegal operations.

Payment for information which results in the seizure of contraband cigarettes is practiced in several states. Payment is provided for on both a per carton basis, between 25c and 50c per carton, and as a percentage of the value of the forfeited cigarettes. The head of the Cigarette Enforcement Unit believes that such a monetary inducement will significantly increase the willingness of both persons engaged in other illegal activities and members of the general public to report cigarette smuggling operations. The Governor's Management Task Force has also endorsed the use of informer fees. Appendix L of the Task Force's recommendations (House, No. 5900) proposes that Chapter 64 of the General Laws be amended to provide for payment of between 10 and 20 percent of the value of the seized cigarettes. The specific percentage is to be determined by the presiding judge on the basis of the assistance given by such person but should not be less than $50. The establishment of a toll-free "hot-line," the use of media time, and increasing industry involvement are all aimed at supplementing traditional enforcement efforts by eliciting the aid of outside parties.

A final change which has been endorsed by the Department of Revenue would require that payment of the cigarette excise be evidenced only by stamps affixed to the cigarette package rather than by metered impressions. Such legislation has been filed by Senator Robert E. McCarthy of the Second Plymouth District and Chairman of the Joint Committee on Taxation (Senate, No. 1664).

Both the Department and the Senator believe that the ink impressions used by some wholesalers in the state can be easily counterfeited. The use of stamps is also endorsed by the ATF, numerous revenue departments in other states, and the 1976 Management Task Force appointed by then Governor Michael S. Dukakis.

Other States' Activity

The magnitude of enforcement efforts allocated to the suppression of cigarette bootlegging varies greatly among the northeastern states. For example, Pennsylvania has 25 special investigators assigned exclusively to cigarette contraband enforcement whereas Rhode Island has only one. Statutory penalties are more uniform among the states. Connecticut law is typical and provides for a fine of not less than $250 nor more than one year imprisonment for the first violation of the prohibition against the sale of untaxed cigarettes. Each subsequent violation exposes the defendant to a fine of not less than $500 nor more than $2,000 and/or imprisonment of not more than one year. Conviction for sale of more than 20,000 untaxed cigarettes can result in a fine of not less than $500 nor more than $5,000 and/or confinement up to five years.

The Commonwealth of Massachusetts

CIGARETTE BOOTLEGGING

CHAPTER 1. INTRODUCTION

Origin of Study

This report is submitted by the Legislative Research Council pursuant to Senate, No. 1611 of 1979, which was filed by Senator Anna P. Buckley of Brockton, Chairman of the Legislative Research Council. That legislative directive, reprinted on the inside cover of this report, required the Council to make a study and investigation relative to the laws, practices, and procedures of Massachusetts and other states for the prevention of the bootlegging of cigarettes and other tobacco products. The order reflects increasing legislative concern relative to (a) insuring that present revenue sources be utilized to their fullest potential and (b) evidence of major revenue losses being experienced by the state as a consequence of cigarette smuggling.

Scope of Study

It was determined at the outset of the study that bootlegging of tobacco products other than cigarettes is virtually nonexistent. Therefore, the report addresses only the problem of cigarette smuggling. Reports by a variety of governmental bodies and enforcement agencies were examined and a thorough review was made of recent congressional hearings on the subject. In addition, numerous officials in other states were contacted either by mail or telephone to solicit their views on the subject.

The report examines the economic importance of tobacco to both the states and the federal government and traces the historical development of cigarette taxation on both levels. The different methods of cigarette tax evasion are defined and discussed, with particular emphasis on Massachusetts experiences. Revenue loss estimates by several sources are included as is an estimate computed by the Legislative Research Bureau. Past attempts to elicit federal assistance in curtailing cigarette smuggling are summarized and the recently enacted federal "contraband" law is discussed. Also included is a listing of recent enforcement actions taken by the federal Bureau of Alcohol, Tobacco and Firearms.

Past and present efforts by the Massachusetts Department of Revenue to curtail cigarette smuggling are evaluated, with particular emphasis upon those factors which have hindered their effectiveness. Current proposals for legislative action to enhance the state's enforcement efforts are presented along with a brief discussion of other states' cigarette tax enforcement programs.

CHAPTER II. ECONOMIC IMPORTANCE OF THE TOBACCO INDUSTRY

It is estimated that one-third to one-half of the adult population of the United States use cigarettes and other tobacco products. Per capita cigarette consumption has increased from 0.6 cigarettes in 1865, the first year for which data is available, to 2,818 (approximately 141 packs) in 1978.[1] During 1977, the American public spent approximately $17 billion on tobacco products, $16 billion of which was for cigarettes. An additional $0.2 billion in capital expenditures were attributable to tobacco and related products. This $17 billion expenditure accounts for $1.00 out of every $75 of all retail expenditures and $1.00 out of every $27 spent on nondurable consumer goods. This outlay for tobacco products was about 41 percent of the sum spent on new automobiles, 151 percent of the amount spent for drugs and sundries and approximates the total amount spent for radios, televisions, records, and musical instruments. When the effects of both personal consumption and capital expenditures are multiplied throughout the economy an additional $23.1 billion in consumption spending and $13.7 billion in capital investments are attributable to the tobacco industry.

[1] Consumption per person (18 years and older) is about 200 packs.

Tobacco production was one of America's first successful commercial enterprises and dates back to the establishment of Jamestown, Virginia in 1612. By 1619, tobacco had become the leading export of Virginia where it was later used as a basis for currency. Tobacco remained the nation's leading export commodity throughout the colonial period and into the early years of independence. Its production spread into other states and today 18 states grow some form of tobacco.

Agriculture

A major agricultural commodity, tobacco is grown on approximately 276,000[1] farms in 18 states. The acreage devoted to tobacco growing is typically small, averaging about three and one-half acres per farm.[2] A high value crop, tobacco returned an average of $710 per acre to land and management resources in 1977, compared to an average return of $49 for corn and $78 for soybeans. While machines and chemicals have replaced much of the stoop-labor and manual tasks in the harvesting of most agricultural commodities, tobacco production remains highly labor-intensive. A tobacco crop requires approximately 270 hours of labor input per harvested acre compared to about 3.5 hours for grain crops. In 1977, five percent of all labor used on farms, or about 247 million hours, went into tobacco production. Although conditions vary among the states, a large part of the domestic tobacco production industry is characterized by low-income, unskilled producers. The high return per acre and the ability to utilize family (owner-operator) labor has made tobacco one of the few crops which can still provide an adequate income on a small family farm. Tobacco production provides a livelihood for women and children, handicapped and older persons, and unskilled laborers, with few employment alternatives. In 1977 tobacco farming provided employment for 124,000 persons whose total compensation amounted

[1] This figure represents the most recent United States Department of Agriculture estimate. A 1979 study by the Applied Research Center of the Wharton School of the University of Pennsylvania estimated that 490,000 farms were engaged in the production of burley and flue-cured tobaccos.

[2] However, the range is considerable. In Tennessee, the average is slightly over one acre whereas Connecticut farms average 37 acres.

to $522 million. Proprietors' income (operators and allotment holders) was about $700 million.

The 0.3 percent of the nation's cropland devoted to tobacco farming in 1977 generated sales of $2.3 billion which represented 2.5 percent of farm cash receipts from crops and all farm commodities. Tobacco crops ranked fifth in value among cash crops (after corn, soybeans, wheat, and cotton) and tenth among all U.S. farm commodities (after the previous four crops plus cattle, hogs, milk, eggs, and broilers). Tobacco sales are twice as large as either rice, potato, or citrus fruit sales and three times larger than peanuts.

Of the six basic classes of tobacco established by the U.S. Department of Agriculture to distinguish different varieties, only two are used in cigarette production, flue-cured and burley. Flue-cured production provides approximately 65 percent of the total U.S. tobacco crop; burley accounts for an additional 30 percent. Flue-cured, which takes its name from the heated air method of curing, is grown principally in North Carolina, South Carolina, Virginia, Georgia, and Florida. Burley tobacco is mainly a product of Kentucky and Tennessee. Other types of tobacco for cigarettes, cigars, and chewing are produced in Maryland, Connecticut, Pennsylvania, Ohio, Indiana, *Massachusetts,* Wisconsin, Missouri, West Virginia, Louisiana, and Alabama.

Although tobacco production occurs in 18 states, its importance is negligible in two states and it is highly concentrated in six states in the southeast. These six states (North Carolina, Kentucky, South Carolina, Virginia, Tennessee, and Georgia) account for more than 90 percent of total tobacco allotments, farms producing tobacco, cash receipts, and employment. The following table shows, by state, the percentage of cash receipts from crops and all farm commodities represented by tobacco crops.

Although the percentage of total receipts represented by tobacco crops has decreased in all but three states (Va., Mo., and Wisc.) since 1970, it is still a major contributor to the agricultural economy of the main producing states. In contrast to the national tobacco cash receipts average of 2.5 percent of total farm cash receipts, the average for the six major producing states was 20 percent, ranging from a high of 33.8 percent in Kentucky to

a low of 6.9 percent in Georgia. The economic importance of tobacco to these states can be further illustrated by the number of farms producing tobacco as a percentage of total farms. In Kentucky tobacco is grown on 83.1 percent of the farms in the state. This high percentage reflects the fact that Kentucky provides two-thirds of the burley and one-half of the dark tobacco produced in the United States. Since U.S. production represents over one-half of the burley tobacco produced in the world, Kentucky grown burley accounts for one-third of total world production. In Tennessee 50 percent of the total number of farms produce tobacco as do 43 percent in North Carolina, 29 percent in Virginia, 13 percent in South Carolina, and 7 percent in Georgia.

Manufacturing and Distribution

The manufacture of tobacco products is another element of its economic importance. In 1977, there were approximately 167 tobacco product factories with federal permits to manufacture cigarettes and cigars. Approximately 35 other facilities manufacture chewing, pipe, and roll-your-own tobacco as well as snuff. These factories are located in 26 states. Cigarette production is by far the largest part of the manufacturing sector and in 1976 manufacturers' gross receipts were about $6 billion, including $2¼ billion of federal excise taxes passed on to the trade. There are presently six companies engaged in the manufacture of cigarettes and virtually all of the production occurs at eleven facilities located in three states (North Carolina 5, Virginia 3, and Kentucky 3). Manufacturers' sales of other tobacco products were approximately $600 million, including $45 million of federal excises. In 1977, manufacturers of tobacco products employed 55,000 workers, with a payroll of $942 million. Another 10,400 persons work for cigar manufacturers and an additional 14,000 persons are employed in the stemming and redrying industry.

Wholesale and retail distribution is the third element of tobacco's contribution to the nation's economy. Unlike production and manufacturing activities, which are highly concentrated in a few states, wholesale and retail establishments are dispersed among the states. About 3,000 tobacco wholesalers handle tobacco products as part of their general wholesale business. Approximately 1,720 of these companies deal primarily in cigarettes

Table 1. *Cash Receipts from Tobacco as Percentage of Cash Receipts from Crops and All Farm Commodities, by State, Average 1966-70, Annual 1975-77*
(Millions of Dollars)

	Average 1966-70		*1975*		*1976*		*1977*[1]	
State	*Tobacco*	*Percent of Total Receipts*	*Tobacco*	*Percent of Total Receipts*	*Tobacco*	*Percent of Total Receipts*	*Tobacco*	*Percent of Total Receipts*
N.C.	$518	38.4%	$951	35.5%	$999	35.4%	$866	32.8%
Ky.	294	35.1	408	27.7	522	31.3	619	33.8
S.C.	95	23.4	188	22.5	154	18.4	171	21.5
Va.	84	15.6	149	14.7	170	16.4	163	15.8
Tenn.	81	12.6	122	11.0	152	11.6	164	11.8
Ga.	85	7.9	154	6.9	138	6.1	150	6.9
Fla.	30	2.5	29	1.4	36	1.4	31	1.2
Md.	21	5.9	29	4.3	22	3.2	30	4.5
Conn.	26	16.1	36	15.0	30	13.0	34	14.7
Pa.	11	1.2	15	0.9	11	0.6	14	0.8
Ohio	14	1.1	21	0.8	22	0.8	29	1.0
Ind.	10	0.7	15	0.5	17	0.5	24	0.7
Mass.	10	6.2	13	4.0	11	5.1	11	5.0
Wis.	5	0.4	14	0.5	16	0.5	14	0.5
Mo.	3	0.2	6	0.2	4	0.2	5	0.2
W.Va.	2	2.4	3	2.0	3	2.1	4	0.3
U.S.[2]	$1,292	2.8%	$2,155	2.4%	$2,320	2.4%	$2,329	2.5%

[1] Subject to revision.
[2] U.S. total receipts from tobacco include relatively small receipts for a few States not shown separately.

Source: Tobacco Situation, June 1978, p. 25.

and in 1977, cigarettes alone accounted for 69 percent of their total sales revenues. These companies were responsible for 93 percent of all cigarette sales at the wholesale level. About 610,000 retail outfits sell tobacco products, consisting of around 210,000 regular retail outlets and approximately 400,000 cigarette vending machine locations. Although it is difficult to measure exactly the level of employment and compensation attributable to the wholesale and retail distribution of tobacco products, the United States Department of Agriculture has estimated that 200,000 jobs and wage and salary income of $2 billion are attributable to these sectors.

Exports

Tobacco exports also play an integral role in the economic importance of the tobacco industry. The United States is currently the world's leading tobacco exporting country and the third largest tobacco importer. In 1977, the excess of exports over imports was approximately 24 percent of total domestic production. As a result, tobacco makes a favorable contribution to the country's balance of payments. Tobacco exports account for an average of four percent of total United States agricultural exports. In terms of value, tobacco exports rank fourth or fifth (after feed grains, soybeans, wheat, and sometimes cotton). In 1976, North Carolina's export share of tobacco was in excess of 50 percent of the U.S. tobacco total. The allocation of export shares based upon production indicates that tobacco dominated export shares of agricultural products for Connecticut (81 percent), North Carolina (60 percent), and Massachusetts (50 percent).[1] The export shares of tobacco was near or over one-third of agricultural exports for Kentucky (32 percent), Virginia (34 percent), and South Carolina (36 percent). Tobacco exports represented 19 percent of total agricultural exports in Georgia and less than six percent for all other producing states.

Tax Impact

The final element of tobacco's impact on the states' and national economy is taxation. Cigarettes are currently taxed by the federal government, all 50 states, the District of Columbia, and nu-

[1] Tobacco grown in Connecticut and Massachusetts is of the cigar binder and wrapper variety.

merous local governments. Twenty states also tax other tobacco products. In 1979, federal, state, county and city excise taxes on cigarettes totaled in excess of $6 billion or approximately $28 for every man, woman, and child in the United States. Depending upon his/her state of residence, a pack a day smoker pays from $40.16 to $116.80 a year in taxes.

In 1979, the average retail price of a standard pack of twenty cigarettes was 60c.[1] Retail prices ranged from a high of 70c in Florida to a low of 46c in Kentucky. As a percentage of total costs, taxes ranged from 39 percent in North Carolina to 114 percent in Florida. The Massachusetts state tax of 21c combined with the federal tax of 8c represents 104 percent of the basic cost. In the absence of all taxes, cigarettes would retail for 28c, a price sufficient to cover production, manufacture, and distribution expenses and normal profits.

In 1977, excise and sales taxes on all tobacco products accounted for 9.3 percent of all indirect business taxes collected by the federal government and for three percent of such levies collected by state and local governments. The core sectors of the industry (farming, auction warehousing, manufacturing, wholesaling, and vending) contributed more than one cent to every federal dollar and 1.8 cents to every state tax dollar collected in 1977. Gross city and county taxes on cigarettes totaled $124.3 million in 1977. The farming and manufacturing sectors contributed an additional $33 million to local treasuries in the form of real estate and personal property taxes. The table below indicates the direct contributions in 1977 of the tobacco industry's core sectors and their support industries in terms of employment, wage payments, and state and local taxes among the 50 states and the District of Columbia.

Conflicting National Policy

The impact of tobacco on both the national economy and the states has resulted in the adoption by the federal government of an ambivalent national policy relative to cigarette consumption. On the one hand, its objective is to discourage Americans from smoking while on the other hand, the government subsidizes the tobacco industry to maintain production levels. Since 1933, the

[1] Including state and federal excise taxes and state sales taxes but excluding municipal taxes.

Table 2. *Direct Contribution of Tobacco Industry Core Sectors and Support Industries to Employment, Wages, and Taxes by State, 1977*

State	*Number of Employees*[1] *(000's)*	*Wages ($000,000's)*	*State and Local Taxes*[2] *($000,000's)*
Alabama	1.4	$ 19.0	$ 61.3
Alaska	.2	1.7	5.0
Arizona	.6	8.3	42.6
Arkansas	.7	9.6	46.7
California	6.3	86.7	392.5
Colorado	.2	2.4	34.7
Connecticut	1.4	19.5	78.7
Delaware	.2	3.1	12.9
District of Columbia	.4	5.9	15.6
Florida	2.2	32.7	226.8
Georgia	10.0	62.2	92.7
Hawaii	.3	4.4	11.2
Idaho	.2	3.8	11.8
Illinois	5.2	71.0	214.3
Indiana	2.2	31.3	75.7
Iowa	1.4	20.7	57.6
Kansas	.9	13.6	39.5
Kentucky	56.8	319.5	66.8
Louisiana	2.3	19.5	70.9
Maine	.4	6.0	25.3
Maryland	1.7	23.9	69.8
Massachusetts	2.6	36.3	151.6
Michigan	3.8	52.3	167.2
Minnesota	1.5	21.3	86.9
Mississippi	.7	10.6	40.9
Missouri	1.9	28.6	70.5
Montana	.3	4.3	11.8
Nebraska	.7	9.3	28.0
Nevada	.9	2.6	13.9
New Hampshire	.3	4.0	27.9
New Jersey	4.3	58.8	174.6
New Mexico	.4	5.4	17.0
New York	7.1	97.5	394.7
North Carolina	68.5	478.3	139.1
North Dakota	.2	3.8	10.3
Ohio	4.7	64.9	209.7
Oklahoma	1.2	15.2	51.3
Oregon	.9	11.9	33.9
Pennsylvania	5.5	75.3	263.3
Rhode Island	.3	6.3	25.4

Table 2. (Continued)

State	Number of Employees[1] (000's)	Wages ($000,000's)	State and Local Taxes[2] ($000,000's)
South Carolina	8.7	46.0	39.1
South Dakota	.2	3.9	9.5
Tennessee	15.6	109.0	81.9
Texas	4.3	60.0	284.0
Utah	.4	5.3	10.2
Vermont	.2	2.6	9.9
Virginia	25.4	237.5	74.6
Washington	1.4	19.8	68.3
West Virginia	1.1	13.4	35.9
Wisconsin	1.8	24.5	100.4
Wyoming	.2	1.9	5.0
Rounding Discrepancies	—1.4	—2.5	—.6
Total	258.7	$2,277.9	$4,288.6

[1] Includes the five core sectors and the support industries for the manufacturing sectors.

[2] Includes state excise and sales taxes on cigarettes, property and real estate taxes paid by manufacturers and farmers, state corporate taxes paid by the core sectors' companies, and the personal income taxes paid by core sector employees.

Source: The Wharton Applied Research Center of the University of Pennsylvania, *A Study of the Tobacco Industry's Economic Contribution to the Nation, Its Fifty States, and the District of Columbia,* April 1979, pp. 10 and 11.

U.S. Government, through the Department of Agriculture, has encouraged tobacco production by controlling supplies, supporting prices, subsidizing exports, and providing marketing assistance. Since 1954, the government, through the Surgeon General's office, has condemned cigarette smoking as a principal factor in the incidence of lung cancer and heart disease. Other anti-smoking educational and health related research programs have been conducted by several government agencies, including the Department of Health, Education and Welfare, the Food and Drug Administration, and the Federal Communications Commission. The conflict inherent in this approach was highlighted in 1977, when Secretary of Health, Education and Welfare Joseph A. Califano called

for an immediate termination of the tobacco support programs while the Secretary of Agriculture Bob Bergland defended the programs and warned against any precipitous cessation.

The geographic concentration of tobacco growers and manufacturers in a few states has enhanced their political influence. Tobacco enjoys the status of a "privileged" commodity in these states and their congressmen play an active role in guarding the interests of this constituency. This concentration has also contributed to the growing disparity in state cigarette tax rates. As the nonproducing states increasingly raised their taxes to provide for marginal funding needs and to discourage consumption, the producing states have maintained low rates of taxation. The resulting disparities made it profitable to transport cigarettes between states and gave rise to the development of cigarette bootlegging.

CHAPTER III. CIGARETTE TAXATION

Federal Taxation

Cigarettes have been subject to taxation since the federal government first imposed an excise tax of 0.8c per pack of 20 cigarettes on June 30, 1864. Federal tax revenue derived from cigarette taxes has grown from $15,000 in 1865, when cigarettes represented 0.1 percent of total tobacco revenue, to about $2.4 billion in 1979, when cigarettes accounted for 98.3 percent of total tobacco collections. The small percentage of total tobacco revenue derived from cigarettes prior to 1920, at which time their contribution had grown to slightly more than 50 percent, reflects the fact that cigarettes were virtually unknown prior to the middle of the 19th Century. Measured by leaf requirements, cigarette consumption did not surpass snuff until 1911, cigars, until 1921, pipe tobacco until 1923, and chewing tobacco until 1925. Cigarette taxes have exceeded 95 percent of total federal tobacco tax collections since 1953. While federal tobacco tax revenue has increased dramatically in absolute terms, its relative contribution to total federal revenue has shown a marked decline. Between 1901 and 1910, tobacco taxes averaged 8.6 percent of total federal tax revenue. Its contribution peaked at 11.4 percent between 1931 and 1940, and declined precipitously thereafter. By 1955, tobacco taxes accounted for only 3.9 percent of total tax receipts and in 1979 the $2,397,000,000 raised by federal taxation of tobacco products was only 0.5 percent of total federal tax collections.

At present, the federal excise tax on a standard pack of 20 cigaretes is 8c and is known as the federal removal tax. In contrast to state cigarette taxes which are generally paid by the wholesaler, the federal tax is levied at the point of manufacture. In the past, manufacturers were required to purchase stamps, signifying payment of the federal tax, on a daily basis. Now, by using highly accurate counting machinery, manufacturers report and pay their tax on a monthly basis. These monthly reports are checked by representatives of the Internal Revenue Service who are in permanent attendance at the plant.

The federal tax of 8c was set in 1951. Recent attempts to increase the tax have been unsuccessful. Arguments in favor of increasing the federal excise tax have taken two forms. First, it is argued that the present rate is unrealistic in the light of recent inflationary trends. Proponents of this view point out that 8c in 1951 is the equivalent of 20c today and that the federal excise tax represents only one-seventh of the cost of a pack of cigarettes today compared to one-third of the average price in 1951. Other advocates contend that higher cigarette levies will discourage consumption and shift the medical costs of smoking from the general public to the smoker. Citing a growing body of scientific evidence linking cigarette consumption to a whole range of catastrophic illnesses, they argue as follows:

> Since 1951, medicare and medicaid were enacted as was the disability insurance program of social security and the supplemental security income program. It has been estimated that $8.2 billion a year is spent directly on health care costs attributable to smoking. Since medicare and medicaid pay forty percent of the Nation's hospital bills, that translates to a $3.3 billion cost to taxpayers generally. Similarly, 1.5 million individuals collect

> social security disability payments as a result of lung or heart ailments and a large number receive SSI payments as well As a result, the American people, nonsmokers as well as smokers, are subsidizing the real costs associated with cigarette smoking. We are now talking about expanding the Federal Government's role in the health area through some form of catastrophic health insurance legislation. If we do pass such legislation without a concomitant increase in the cigarette tax, we are asking the American people to subsidize even further the real costs associated with smoking.[1]

State Taxes

The first state cigarette tax was enacted in Iowa in 1921 at a rate of 2c per pack. During the twenties, ten other states followed suit. The enactment of cigarette taxes in these states is generally attributed to a combination of growing demands for property tax relief for the agricultural sector and a developing anti-tobacco sentiment. Cigarette taxes offered a means of shifting the state tax burden from agricultural lands to a "luxury" consumption item and from the nonsmoker to the smoker. The anti-tobacco movement was not a new development. In the early part of the 20th Century, Iowa, Kansas, North Dakota, Tennessee, and Utah had laws prohibiting the sale of cigarettes. Increased revenue needs and changing social mores resulted in the repeal of these laws and by 1927, cigarettes were legal in all 50 states. The onset and worsening of the depression increased state governments' needs for additional tax sources and by 1935, cigarettes were subject to taxation in 19 states. During the next 15 years, taxation of cigarettes became increasingly popular; by 1950, 40 states and the District of Columbia levied an excise tax on cigarettes. The number of states taxing cigarettes remained fairly stable over the next eight years and by 1958, only 42 states had enacted tax legislation. By 1961, 47 states had entered the field and the imposition of taxes in Colorado in 1964, Oregon in 1967 and North Carolina in 1969 extended cigarette taxes into all the states. Net state cigarette tax collections have increased from $324,000 in 1921 to $3,621,625,000 in 1979. As a percentage of total state tax collections (excluding employment taxes), taxation of all tobacco

[1] *Congressional Record,* March 27, 1979, p. 3522.

products increased from one percent in 1932 to a peak of 5.3 percent in 1961, and has declined to 3.5 percent in 1978. Total state cigarette tax collections have exceeded federal collections since 1969.

In addition to becoming more widespread, cigarette taxes have been assessed at increasing rates over the years. With the exception of North Carolina, every state has increased its tax rate since it was first initiated. The following table shows the upward movement of state cigarette taxes from 1950.

As indicated by the table, the disparity in tax rates among the states has increased dramatically since 1960. In 1960, the highest state tax was 8c and was levied by three states. The largest difference in cigarette taxes between any two states was also 8c. By 1965, 18 states had raised their tax rate to 8c and an additional three states had exceeded that level. As a result, the divergence in tax rates had grown to 11c. Over the next five years there were rate increases in a large number of states and in 1970, 39 states levied taxes of 8c or more. The largest difference in cigarette taxes between any two states had increased to 16c. Rates and differentials have continued to increase and at present only three states impose taxes of less than 8c and the largest difference between states is 19c.

Two factors contributed to the rise in cigarette tax rates: (1) a persistent need for additional tax revenue and (2) a decline in concern with the effect of tax increases on consumption coupled with an implicit assumption that such increases would not significantly reduce consumptions. Faced with costs for providing municipal services and welfare benefits formerly borne by local government as well as a growing resistance to increases in property taxes, state governments turned to cigarette tax increases as a marginal revenue source. Cigarette tax increases are ideally suited to marginal revenue needs because the revenue derived from this source is relatively stable in the face of economic fluctuations. Nor do such increases, in the non-producing states, entail negative political repercussions. The issuance in 1964 of the Surgeon General's report on smoking added further impetus to state tax increases and in 1965, a record number of states, 22, increased their

Table 3. *State Cigarette Taxes*

Rate (cents per pack of 20)	*1950*	*1955*	*1960*	*1965*	*1970*	*1975*	*1979*
0	8	7	4	2	—	—	—
1	1	—	—	—	—	—	—
2	7	3	3	1	1	1	1
2.5	1	—	—	1	2	1	1
3	16	19	7	2	—	1	—
3.5	—	—	1	1	—	—	—
3.9	—	—	1	1	—	—	—
4.0	9	10	5	3	1	—	—
5	5	6	16	5	1	—	—
6	—	2	9	7	3	2	—
7	—	—	1	6	3	—	1
8	1	1	3	18	9	3	3
9	—	—	—	1	2	3	3
10	—	—	—	1	5	5	4
10.5	—	—	—	—	—	—	1
11	—	—	—	1	4	6	5
12	—	—	—	—	8	8	8
12.25	—	—	—	—	1	—	—
13	—	—	—	—	4	5	6
13.5	—	—	—	—	—	—	1
14	—	—	—	—	2	1	1
15	—	—	—	—	1	2	2
15.5	—	—	—	—	1	—	—
16	—	—	—	—	1	4	3
17	—	—	—	—	—	1	1
17.75	—	—	—	—	—	1	1
18	—	—	—	—	1	3	3
18.5	—	—	—	—	—	1	1
19	—	—	—	—	—	1	1
21	—	—	—	—	—	1	3
Most frequent tax rate	3c	3c	5c	8c	8c	12c	12c
Greatest disparity	8c	8c	8c	11c	16c	19c	19c

Source: Legislative Research Bureau compilation from data in Tobacco Tax Council, Inc., *The Tax Burden on Tobacco*, Volume 14, 1979.

cigarette tax. The disparities between states increased because the tobacco-producing states either maintained their existing rate or enacted minor increases.

Local Government Taxation

In addition to state taxation, seven states permit either or both city and county governments to levy cigarette taxes (Ala., Ill., Mo., N.J., N.Y., Tenn., and Va). In 1979, 348 cities and 17 counties imposed such taxes. The vast majority of cities taxing cigarettes are located in Alabama (221) and Missouri (103). Nineteen cities in Virginia and two in Illinois engage in cigarette taxation with the balance accounted for by individual cities in the remaining states. In 1979, total revenue from city cigarette taxes was almost $110 million. New York City, which tacks on an additional 8c to the state tax of 15c accounted for more than 50 percent of this total. County taxation of cigarettes is practiced in Alabama (12), Missouri (2), Virginia (2), and Tennessee (1). Total county cigarette tax revenue was slightly more than $18 million in 1979.

Thirty-one states also apply the state general sales tax to cigarettes, adding from 1c to 4c to the retail price per pack. Thus, in all 50 states, cigarettes are subject to at least two taxes (federal and state); in 31 states, cigarettes are subject to at least three taxes (federal, state, and general sales); and in six states, they are subject to four taxes (federal, state and municipal excises, and a general sales tax). Virtually, all of the variation in cigarette prices between the states is attributable to differences in state excise and sales taxes.

As the disparity in state cigarette tax rates grew, the motive for tax evasion increased. Growing numbers of smokers in the high tax states sought to reduce their costs by purchasing cigarettes in neighboring states with lower tax rates, or by stocking up in the more distant producing states. The emergence of this market created a situation in which it became profitable to transport large quantities of cigarettes between states for illegal resale. Over time, the magnitude of cigarette tax evasion grew and at present such activities constitute a major cause of lost tax revenue for many states.

CHAPTER IV. COSTS OF CIGARETTE TAX EVASION

Estimating Revenue Losses

A precise determination of the revenue losses resulting from cigarette tax evasion in any particular state is complicated by a number of factors. Unlike crimes against persons or property, for which victim reports provide some measure of incidence, cigarette smuggling is generally perceived as a victimless crime. Contraband cigarettes are distributed either to persons who are willing to purchase their cigarettes through illegal channels or to members of the general public who unknowingly purchase such contraband at legitimate retail outlets. In the first case, the buyer realizes a definite benefit from his participation, in the second, he is unaware of his involvement. In neither case can participants be expected to provide information to law enforcement officials.

A second possible guide in determining the extent of tax evasion is the number of arrests and seizures resulting from current enforcement efforts. However, use of such data must be guarded because such variables may be better indicators of the level of law enforcement priority attached to cigarette smuggling rather than the extent of illegal traffic. For example, a comparison of two states, one of which devotes twice the resources to combatting cigarette smuggling as the other, will conclude that the first state has the greater problem. This may or may not be true. This same factor complicates evaluating a state's own enforcement efforts. An increase in the number of seizures over time may reflect either an increase in traffic, enforcement effectiveness, or enforcement expenditures. A decrease in the number of seizures can be interpreted either as evidence that the enforcement efforts have been successful or that smugglers have improved their methods and as a consequence are more difficult to apprehend. A comparison of the quantity of contraband cigarettes seized by enforcement agents in any of the high tax states with estimates of revenue losses being experienced by those states indicates either that these estimates are significantly over-inflated or that past enforcement efforts have been ineffectual. In 1975, a year in which the federal Advisory Commission on Intergovernmental Relations (ACIR)[1] estimated that approximately 6,000,000 cartons of cigarettes on which the Massachusetts tax had not been paid were consumed by Massachusetts residents, only 3,000 cartons of contraband cigarettes were seized. Because of these limitations, most attempts to estimate cigarette tax evasions losses employ other means.

One of the simplest methods of calculating losses is to compare state per capita consumption to average national per capita consumption and attribute the difference to cigarette tax evasion.[2] While relatively straightforward and intuitively appealing, this approach fails to account for factors such as price, age distribution, rural *vs* urban population ratios, tourist purchases, and other variables which affect state per capita consumption. A preferable approach is to compare a state's per capita consumption ratio prior to the inception of bootlegging to its current ratio. Comparison to changes in the national average provides a means of accounting for non-state specific changes. For example, a marked increase or decrease in cigarette consumption on the national level will be reflected by changes in a state's own per capita consumption. While accounting for variables contributing to disparities in per capita consumption between states, this approach does not allow for changes in these variables over time. Measurement of the true extent of interregional shifts in personal income, population, and other demographic features affecting state per capita cigarette consumption which have occurred during the last decade awaits the completion of the 1980 Census. Having noted its shortcomings, such an approach is presented below.

The table shows that, with the exception of the year 1950, Massachusetts per capita consumption exceeded the national average every year until 1971. On average, the Bay State's per capita consumption surpassed the national average by approximately nine packs over this 20-year period. Further, the table indicates a relatively high inverse responsiveness of consumption to tax

[1] The ACIR's estimates are discussed more fully later in this chapter.
[2] Assuming that the state rate is below the national average.

Table 4. *Per Capita Cigarette Consumption — Federal vs. Massachusetts, 1950-1979.*

Year	*Mass. Excise Tax* (in cents)	*National Per Capita Consumption*[1] (in packs)	*Mass. Per Capita Consumption* (in packs)	*Difference*
1950	5	110.0	109.2	— 0.8
1951	5	111.9	126.4	+ 14.5
1952	5	113.7	121.4	+ 7.7
1953	5	116.2	125.2	+ 9.0
1954	5	111.9	118.9	+ 7.0
1955	5	108.3	117.0	+ 8.7
1956	5	108.3	121.2	+ 12.9
1957	5	112.4	124.3	+ 11.9
1958	5	114.5	126.6	+ 12.1
1959	6 (7/29/58)	119.7	128.4	+ 8.7
1960	6	123.8	131.1	+ 7.3
1961	6	127.6	136.0	+ 8.4
1962	6	127.5	138.2	+ 10.7
1963	6	128.3	142.2	+ 13.9
1964	6	124.3	138.7	+ 14.4
1965	8 (1/1/65)	126.8	136.5	+ 9.7
1966	10 (3/3/66)	124.5	131.6	+ 7.1
1967	10	125.3	130.2	+ 4.9
1968	10	122.3	128.0	+ 5.7
1969	12 (6/2/69)	121.1	129.7	+ 8.6
1970	12	118.3	124.3	+ 6.0
1971	16 (5/1/71)	121.9	121.4	— 0.5
1972	16	124.7	117.9	— 6.8
1973	16	126.3	121.2	— 5.1
1974	16	129.9	124.3	— 5.6
1975	16	130.9	126.1	— 4.8
1976	21 (7/1/75)	133.2	116.9	—16.3
1977	21	133.6	118.9	—14.7
1978	21	133.8	120.5	—13.3
1979	21	132.0	118.2	—13.8

[1] All taxing states weighted average per capita.

Source: Legislative Research Bureau compilation from data in Tobacco Tax Council, Inc., *The Tax Burden on Tobacco,* Volume 14, 1979.

increases enacted in the last decade. Each time an increased cigarette excise was levied, the growth trend in Massachusetts per capita consumption relative to the national average was reversed. With the imposition of a 16c tax rate in 1971, state per capita consumption fell below the national average for the first time in over 20 years. Moreover, Massachusetts per capita consumption has shown a marked decline in the last eight years, averaging approximately nine packs below the national average. The proportion of this decrease attributable to actual reductions in consumption versus cigarette tax evasion is uncertain. A conservative assumption, one that takes into account both the responsiveness of consumption to tax increases and the fact that the Commonwealth's per capita consumption historically exceeded the national average prior to 1971, is that present Massachusetts per capita consumption should at least equal the national average. On this basis Massachusetts residents should have consumed approximately 80 million more packages of cigarettes in 1979 than is indicated by the number of tax paid sales which occurred in that year. Applying the 21c excise tax to this disparity results in an excise tax loss estimate of almost $17 million.[1]

Council Against Cigaret Bootlegging

A variation of this method was utilized in a 1977 report prepared by the Council Against Cigaret (sic) Bootlegging,[2] which examined the impact of illegal traffic in cigarettes in eight Eastern Seaboard states.[3] The Council chose a base year for each state, reflecting the year in which a significant level of bootlegging was assumed to have first occurred. Consumption loss figures were then estimated on the assumption that the number of packages taxed in each state would have increased with the growth trend in

[1] This estimate is based upon data contained in the 1979 edition of the Tobacco Tax Council report titled *The Tax Burden on Tobacco.*

[2] Council Against Cigaret (sic) Bootlegging, *A Statistical Report on the Effects of Cigaret (sic) Bootlegging in the Eastern Seaboard United States,* New York, May 1977.

[3] Maryland, Delaware, Pennsylvania, New Jersey, New York, Connecticut, Rhode Island, and Massachusetts.

Table 5. *Number of Packs Bootlegged, Tax Losses, and Organized Crime Profits in Eight Eastern Seaboard States, 1964-1976.*

A. ALL STATES

State	*Number of Packs Bootlegged*	*Lost Taxes*	*Crime Profits*
New York	5,052,200,000	$1,047,800,000	631,525,000
New Jersey	2,019,900,000	327,100,000	252,487,500
Pennsylvania	1,859,600,000	315,700,000	232,450,000
Connecticut	681,200,000	135,300,000	85,150,000
Massachusetts	1,212,300,000	181,300,000	151,537,500
Delaware	106,800,000	14,200,000	13,350,000
Maryland	52,200,000	5,200,000	3,393,000
Rhode Island	5,600,000	1,000,000	700,000
Total	10,989,800,000	$2,027,600,000	$1,370,593,000

B. MASSACHUSETTS
(in Millions)

Fiscal Year	*Expected Sale if the Growth Trend Had Not Been Interrupted by Bootlegging*	*Decline in Packs*	*Loss in State Cigaret Taxes Due to Bootlegging*
1965 (1)	728.5	—	—
1966 (2)	700.0	34.5	$2.9
1967	747.7	47.0	4.7
1968	759.5	65.5	6.6
1969 (3)	773.3	64.2	6.4
1970	780.1	100.3	12.0
1971 (4)	820.7	128.6	15.4
1972	836.6	157.7	25.2
1973	848.4	147.3	23.6
1974	860.5	137.6	22.0
1975	865.4	133.8	21.4
1976 (5)	877.1	195.8	41.1
Total		1,212.3	$181.3

(1) Cigaret tax rate increased from 6c to 8c on January 1, 1965.
(2) Cigaret tax rate increased from 8c to 10c on March 3, 1966.
(3) Cigaret tax rate increased from 10c to 12c on June 2, 1969.
(4) Cigaret tax rate increased from 12c to 16c on May 1, 1971.
(5) Cigaret tax rate increased from 16c to 21c on July 1, 1975.
Source: Council Against Cigaret (sic) Bootlegging.

the country and would reflect both the increase in population and the percent gain in cigarette consumption (26.8%) which occurred between 1964 and 1976. The report also attempted to estimate profits accruing to the underworld on the basis of a $1.25 profit per carton except in Maryland where, because of the generally lower tax rate, 65c per carton was used. The major drawbacks to this approach are its failure to account for changes in consumption in response to changes in a state's population characteristics and its assertion that all cigarette smuggling is performed by organized crime. The use of a $1.25 per carton profit estimate is also questionable since, prior to 1971, the Massachusetts cigarette excise tax added only $1.20 to the retail price of a carton of cigarettes. The Council's estimates of the total tax losses incurred by the subject states (including Massachusetts) are presented below.

Advisory Commission on Intergovernmental Relations

The most rigorous method of computing revenue losses attributable to cigarette tax evasion is that employed by the Advisory Commission on Intergovernmental Relations in its 1977 report titled *Cigarette Bootlegging: A State and Federal Responsibility.* Most parties consider the ACIR estimates to be the most accurate measurement of the revenue losses (and gains) occurring in the states. A dissenting view was included in a 1979 report by the Florida Council On Intergovernmental Relations[1] as follows:

> . . . In the methodology employed by the Federal ACIR, a regression analysis of cigarette demand was used to estimate gains and losses from cigarette bootlegging. It was assumed that every state was uniform with respect to bootlegging factors. The explanatory variables were broken down into two sets. The first set, those affecting smuggling, were price differential and interstate smuggling dummy variables, and the state and local tax on cigarettes. The second set contained per capita income, tourism, age, religion, region and the state and local tax. The elasticity of demand (consumption rate) was estimated at .34.
>
> The Council feels that there are several problems with respect to this methodology: First, assuming that each state is uniform with respect to bootlegging results in a failure to consider various *intra-state* variables such as tax free sales. Although this variable would produce little change in the interstate factor, the loss estimate of several states, particularly those containing a high level of tax free sales (i.e. Florida) would be affected. Secondly, question arises as to the propriety of using a dummy variable approach in this experiment. The problem is that it is not known exactly what the dummy variable is meant to explain. It is bound to be statistically significant, yet attributing it to cigarette bootlegging could possibly be an erroneous assumption. A more feasible approach would have been to use actual sales data. However, this factor was not considered in the Federal ACIR's methodology. Thirdly, a significant drawback in the estimate is the fact that the elasticity or consumption figure of .34 was more applicable ten years ago. Robert Klein, the author of the Federal ACIR report, stated in a conversation during the early stages of this study, that the consumption figure was an average taken from reports dating back ten years.
>
> In attempting to estimate the degree of Florida's cigarette bootlegging problem, it is important to look beyond the realm of economic assumption.
>
> Since 1975 there have been 163 arrests for the illegal trafficing (sic) and sale of cigarettes in Florida. If these cigarettes had been taxed at the prevailing Florida tax rate, a total of approximately $92,160 would have been collected. When considering this amount of potential tax revenue in relation to the Federal ACIR's estimate only two conclusions can be reached; 1) the current state enforcement effort is not successfully confronting the problem or 2) Florida does not have a substantial bootlegging problem and the Federal ACIR's estimate is over-inflated.
>
> The majority of the high tax states which are considered to have the worst bootlegging problems, should logically fall far below the national average in per capita sales. In 1977 Florida's per capita sales were 133.1, only slightly lower than the national average of 133.6. This difference is construed as being a result of cigarette bootlegging. However, this difference does not correspond with the Federal ACIR's $35 million loss estimate for Florida. Furthermore, it is interesting to note that the low tax states, which are the primary suppliers of bootlegged cigarettes (and should show drastic increases in per capita sales in relation to the magnitude of the bootlegging problem), have shown definite decreases in per capita sales:

	1976	*1977*	*Variance*
Florida	130.3	133.1	+ 2.8
Kentucky	230.9	229.4	— 1.5
North Calorina	230.2	217.0	—13.30
Virginia	158.1	157.7	— .4

The ACIR methodology involved three steps. First, a statistical

[1] Florida Advisory Council on Intergovernmental Relations, *Issues in Cigarette Taxation,* January 1979, pp. 8 and 9.

approach known as multiple regression analysis was used to isolate the effect of the cigarette tax rate from other factors believed to influence per capita cigarette sales (i.e., per capita income, age distribution of the population, and tourism). The second step separates this impact into two distinct parts, that related to cigarette tax evasion and that related to the effect of tax rates upon consumption. On the basis of its study, the ACIR concluded that reduced consumption accounted for 40 percent of the overall effect of tax rates on per capita cigarette sales. The remaining 60 percent was assumed to be attributable to cigarette tax evasion. The report cautioned that because this 40-60 percent assumption was applied in deriving the revenue loss estimates for each state, the accuracy of the estimates may vary by state. The third step involved the use of the estimates derived from the first two steps to obtain estimates of per capita sales losses or gains for each state. These estimates were then converted into revenue gains or losses, in both dollar and percentage terms, for each state. The ACIR's estimates based upon fiscal year 1975 data are presented below. This table has been amended from the original by the juxta-position of columns three and four and the addition of column five, which shows Bureau of Alcohol, Tobacco and Firearms estimates of revenue losses and gains in 1979.

Table 6. *Cigarette Tax Evasion — Winners and Losers*
(Dollar Amounts in Millions)

	Estimated Cigarette Tax Revenues[1]		*Gain or Loss (—)*	*Estimated Gain*	
	Current	*Assuming*	*as Percent*	*or Loss (—)*	
State	*Levels*[2]	*Tax Evasion*[3]	*of Col. 1*	*1975*	*1979*
	(1)	(2)	(3)	(4)	(5)
Alabama	$64.1	$71.0	—10.8%	—$6.9	—$4.3
Alaska	4.1	3.9	4.9	0.2	0.1
Arizona	36.1	39.5	— 9.4	— 3.4	— 0.7
Arkansas	41.1	47.6	—15.8	6.5	— 5.0
California	360.5	376.5	— 4.4	—16.0	—19.9
Colorado	34.4	34.1	0.9	0.3	— 0.2
Connecticut	75.6	90.7	—20.0	—15.1	— 9.9
Delaware	11.5	11.7	— 1.7	— 0.2	— 0.1
District of Columbia	11.3	11.1	+ 1.8	0.2	— 1.0
Florida	204.3	240.0	—17.5	—35.7	—43.0

Table 6. (Continued)

	Estimated Cigarette Tax Revenues[1]		*Gain or Loss (—)*	*Estimated Gain*	
	Current	*Assuming*	*as Percent*	*or Loss (—)*	
	(1)	(2)	(3)	(4)	(5)
State	*Levels*[2]	*Tax Evasion*[3]	*of Col. 1*	*1975*	*1979*
Georgia	82.8	85.6	— 3.4	— 2.8	— 2.1
Hawaii	NA	NA	NA	NA	NA
Idaho	10.5	10.2	2.9	0.3	0.1
Illinois	221.6	243.3	— 9.8	—21.7	—15.7
Indiana	58.6	54.6	6.8	4.0	— 0.7
Iowa	56.1	60.1	— 7.1	— 4.0	— 2.7
Kansas	37.8	39.4	4.2	— 1.6	— 0.9
Kentucky	38.1	24.8	34.9	13.3	10.9
Louisiana	61.0	63.1	— 3.4	— 2.1	— 0.7
Maine	20.4	22.5	—10.3	— 2.1	— 0.8
Maryland	70.8	70.6	0.3	0.2	— 1.3
Massachusetts	122.0	134.1	— 9.9	—12.1	—20.8
Michigan	160.1	167.0	— 4.3	— 6.9	— 4.4
Minnesota	82.0	94.2	—14.9	—12.2	— 8.4
Mississippi	36.0	37.3	— 3.6	— 1.3	— 1.4
Missouri	81.5	86.5	— 6.1	— 5.0	— 2.8
Montana	11.0	11.3	— 2.7	— 0.3	— 0.1
Nebraska	26.5	28.2	— 6.4	— 1.7	— 1.5
Nevada	13.5	13.1	3.0	0.4	0.9
New Hampshire	24.2	12.9	46.7	11.3	11.6
New Jersey	169.4	195.4	—15.3	—26.0	—17.1
New Mexico	16.8	17.8	— 6.0	— 1.0	— 0.1
New York	414.5	486.8	—17.4	—72.3	—53.2
North Carolina	49.0	32.4	33.9	16.6	9.2
North Dakota	10.3	10.5	— 1.9	— 0.2	— 0.1
Ohio	26.3	223.2	— 8.2	—16.9	—11.8
Oklahoma	43.8	45.0	— 2.7	— 1.2	— 3.7
Oregon	29.7	28.2	5.1	1.5	2.2
Pennsylvania	262.7	298.3	—13.6	—35.6	—22.9
Rhode Island	17.4	17.7	— 1.7	— 0.3	— 1.0
South Carolina	32.2	30.8	4.3	1.4	0.6
South Dakota	10.1	10.2	— 1.0	— 0.1	— 0.1
Tennessee	77.5	85.3	—10.1	— 7.8	— 8.1
Texas	249.0	292.1	—17.3	—43.1	—31.0
Utah	9.5	9.2	3.2	0.3	— 0.1

Table 6. (Continued)

State	Estimated Cigarette Tax Revenues[1] Current Levels[2] (1)	Assuming Tax Evasion[3] (2)	Gain or Loss (—) as Percent of Col. 1 (3)	Estimated Gain or Loss (—) 1975 (4)	1979 (5)
Vermont	9.1	8.1	11.0	1.0	1.8
Virginia	49.1	46.6	5.1	2.5	1.9
Washington	70.3	83.5	—18.8	—13.2	— 9.4
West Virginia	32.6	34.5	— 5.8	— 1.9	— 4.2
Wisconsin	95.9	109.5	—14.2	—13.6	— 8.9
Wyoming	4.4	4.2	4.5	0.2	0.3
Total	$3,917.0	$4,254.2	8.6%	—$337.1[4]	

[1] Total includes state and local cigarette taxes, plus state sales tax.
[2] Current tax rates are applied to estimated per capita sales.
[3] Current rates are applied to hypothetical per capita sales.
[4] The total loss to the "losing" state is $390.8 million.

Source: ACIR and Federal Bureau of Alcohol, Tobacco and Firearms.

The ACIR report included the following analysis of their estimates:

> Although many States are only minimally affected by smuggling, more States lose from bootlegging than gain. Among those States substantially affected in terms of the percent of cigarette revenue foregone are Connecticut (20.0 percent), Washington (18.8 percent), Florida (17.5 percent), New York (17.4 percent), Texas (17.3 percent), Arkansas (15.8 percent), New Jersey (15.3 percent), Wisconsin (14.2 percent), Pennsylvania (13.6 percent), and Minnesota (14.9 percent). The States gaining the most from bootlegging in terms of percent of cigarette revenues are New Hampshire (46.7 percent), Kentucky (34.9 percent), North Carolina (33.9 percent), Vermont (11.0 percent), Indiana (6.8 percent), Virginia (5.1 percent), and Oregon (5.1 percent).
>
> Total revenue losses exceed total revenue gains. The sum of State revenue losses amounted to $390.8 million as opposed to $53.7 million gained by low-tax States. The result is a $337.1 million net loss in tax revenue for the State as a whole. The States losing the most revenues are New York ($72.3 million), Texas ($43.1 million), Pennsylvania ($35.6 million), Florida ($35.7 million), and New Jersey ($26.0 million). The low-tax States gaining the most revenue from bootlegging include North Carolina ($16.6 million), Kentucky ($13.3 million), New Hampshire ($11.3 million), Indiana ($4.0 million), and Virginia ($2.5 million). One obvious reason for this imbalance is the large tax per pack lost in the high-tax States compared to the low tax per pack gained by low-tax States. Thus, there are more big losers than big winners, and the amounts lost far exceed the amounts gained.
>
> These estimates encompass some sources of gain and loss other than cigarette bootlegging from one State to another. The imbalance between losses and gains is due in part to the fact that some bootlegging losses are the result of the tax-free sales of cigarettes at Indian reservations and military bases as well as smuggling from Mexico. Such losses are not gained by other states. The imbalance is also due to statistical error, which suggests that either the losses are overstated, the gains understated, or both. These estimates, nonetheless, provide a good scale to judge the bootlegging problem of one state relative to another. Moreover, they seem reasonable compared to other estimates, such as those produced by the New York State Special Task Force on Cigarette Bootlegging.[1]

Dissenting View

At least one public source has questioned the accuracy of studies purporting to show that large scale smuggling of cigarettes is occurring between the low and high tax states. The Attorney General of North Carolina, Rufus L. Edmisten, made the following comments before an ad hoc group of tax officials who met in Columbus, Ohio on September 10, 1979:

> One of the great problems we are having is to determine the factual extent of the cigarette smuggling problem. We have uncovered numerous allegations concerning smuggling but upon close review we have found that most are several years old or that the allegations are personal conjectures. At this point we have very little factual information to go on, therefore, I ask if you do have any factual information that you share it with us . . .
>
> According to information supplied by the Tobacco Tax Council the national per capita consumption based on federal tobacco tax revenue is 142 packs. Using the 50 individual states figures the average consumption is 134 packs per capita. If we split the difference and use 138 packs per capita and multiply that times North Carolina's population of 5.6 million people, then if North Carolinians smoke at the national average, 772.8 million packs of the 1.1 billion packs sold in the state were consumed by North Carolinians. This would leave an availability of approximately 327.2

[1] Advisory Commission on Intergovernmental Relations, *Cigarette Bootlegging: A State and Federal Responsibility,* May 1977, p. 66.

million packs, the disposition of which is left to speculation.[1]

Citing the large number of out of state visitors who take advantage of their travels through North Carolina to purchase a supply of cigarettes for themselves and their friends, and the high volume of cigarettes sold to residents of bordering states, Mr. Edmisten concluded —

> . . . When all of this is factored in it just does not appear that there are large volumes of cigarettes available for smuggling.

Other Costs

The cost of cigarette tax evasion cannot be measured solely in terms of lost tax revenue. Profits realized from large scale smuggling enterprises are sometimes used to finance other illicit activities, such as drug smuggling, which pose an even greater threat to society. Each pack of cigarettes sold in the subterranean market represents a loss to legitimate wholesalers, retailers, and trucking firms. According to a recent article in Forbes magazine, in the last 10 years half of the tobacco wholesalers in New York City have gone out of business. More than a quarter of the licensed retailers — 7,000 altogether — have been forced to close down and Teamsters Union locals there have lost nearly half of their tobacco and vending machine membership. All told, more than 2,000 of the industry's 3,200 drivers, salesmen, clerks, and warehousemen have lost their jobs. It is important to note, however, that the proportion of these losses directly attributable to cigarette smuggling is impossible to determine.

Another cost of cigarette smuggling is the corruption of enforcement officials. Large scale smugglers attempt to reduce their risk by purchasing "insurance" in the form of corrupt officials. Collusion between smugglers and state and/or city officials has been uncovered in both New York and Pennsylvania.

Perhaps the greatest cost of cigarette smuggling is its deleterious effect upon a state's citizen's respect for the law in general. Persons who knowingly purchase untaxed cigarettes can be expected to become increasingly willing to purchase other kinds of contraband, i.e., stolen property, available in the black market. Legitimate retailers and wholesalers are susceptible to becoming tax-evaders and criminals.

[1] *Congressional Record*, September 10, 1979.

CHAPTER V. METHODS OF CIGARETTE TAX AVOIDANCE

Cigarette tax evasion is generally divided into four distinct categories: (1) casual smuggling, (2) organized smuggling, (3) mail order purchase, and (4) purchases through tax-free outlets. The magnitude of the problem represented by any one of these methods varies by state.

Casual Smuggling

Casual smuggling is committed by the individual from a high tax state who travels to a low tax state to purchase cigarettes for himself and his friends. So long as no profit is realized it remains casual smuggling. Examples of such are the person who stocks up while vacationing in or traveling through a low tax state, the Massachusetts resident who travels to New Hampshire to purchase his or her cigarettes, and individuals such as truck drivers, railroad employees, and airline employees who take advantage of their travels to avoid their resident state tobacco tax. The incidence of casual cigarette smuggling in a state is affected by: (a) the tax rates in contiguous or neighboring states; (b) the proximity of large population centers to the lower priced states; (c) the length of its borders and the ease with which they may be crossed; and (d) the enforcement efforts and penalties employed by the state.

Because of its 21c per pack tax levy, Massachusetts presents an ideal environment for casual cigarette smuggling. Its tax rate exceeds that of five of the six states to which it is contiguous. With disparities ranging from 90c per carton for New Hampshire and Vermont to 30c per carton for Rhode Island, Connecticut is the only bordering state with an equivalent tax rate, and it has been restrained in its efforts to raise the tax still further by growing evidence of a serious cigarette smuggling problem. Long borders, an excellent interstate highway system, frequent visits to neighboring states by Massachusetts residents, and limited tax enforcement are factors which tend to indicate that a significant amount of casual smuggling is occurring in the Commonwealth.

More positive support for the contention that a significant proportion of Massachusetts cigarette tax losses is attributable to casual smuggling is provided by a comparison of changes in Massachusetts per capita sales with changes occurring in the bordering states. As noted above, residents of the Bay State can purchase cigarettes at a lower cost in any contiguous state except Connecticut. The greatest savings are available in New Hampshire and Vermont. This fact coupled with the closeness of New Hampshire in particular to the large population centers in the Boston Metropolitan Area makes them the prime sources of supply for Massachusetts residents seeking to evade the state's cigarette tax.

The following table compares per capita cigarette sales for Massachusetts, New Hampshire, and Vermont for selected years dating from 1950. New Hampshire's per capita sales rate has historically exceeded the national average, increasing from 62 percent above that average in 1950 to almost double (192%) the national average in 1979. In fact, New Hampshire's per capita sales rate was the highest in the country in 1979 and only one other state's rate, Kentucky, exceeded 200 packs. The Granite State's exceptionally high per capita sales is attributable to the large number of sales to out of state residents, either persons vacationing in the state or residents of bordering states, who cross over to purchase their cigarettes. A large number of cigarette purchases by non-residents inflates actual per capita consumption since all tax paid sales are attributed to the state's resident population. As shown by the table, Massachusetts per capita sales exceeded the national average by a small margin (an average of nine packs) until 1971. For the past eight years the Bay State's rate has fallen below the national average. On the other hand, Vermont's sales rate has generally surpassed the national average and this disparity has grown in recent years. The table clearly shows that declines in Massachusetts per capita sales following the imposition of higher excise taxes have consistently been matched by significant increases in New Hampshire's per capita sales. Although Vermont has always ranked higher in per capita sales than would be expected in the light of the state's demographic characteristics, cigarette purchases by non-residents appear to have increased since 1971. This is probably due to tax increases in both New Hampshire and Massachusetts. Prior to 1971, the Vermont and Massachusetts excises never varied by more than 1c. However, the imposition of a 16c tax (5/1/71) in Massachusetts created a 40c per carton price differential between the two states. New Hampshire's tax increase of 2.5c in the early 1970's reduced its advantage over Vermont as a source of supply for Massachusetts residents as well as the incentive for citizens of

Vermont to purchase their cigarettes in New Hampshire.

The proprietors of two large Massachusetts tobacco wholesale companies, Notini Brothers, Inc. and Garber Brothers, Inc., both have stated that New Hampshire retail establishments located in close proximity to the Massachusetts border sell ten times as many cigarettes as their counterparts within the Bay State.

This contention is further buttressed by the following passage from the ACIR's report on the subject:

> Revenue gains and losses resulting from the tax differential between bordering States are generally due to either casual smuggling or organized smuggling. Organized smuggling is heaviest in the Northeast and Midwest. In these States, the ultimate consumer is generally responsible for only a small portion of cigarette smuggling, with the remaining part perpetrated by enterprising distributors or criminal elements, often on a large scale. (In some cases, such as along the Massachusetts-New Hampshire border, the majority of smuggling probably is done by the ultimate consumer.) [1]

Although casual smuggling deprives the affected state of revenue just as surely as any other form of tax evasion, this form of cigarette bootlegging has not attracted as much concern as its other varieties. With the exception of tax administrators and some law enforcement personnel, most people view such activities as a relatively benign form of tax evasion.

Organized Smuggling

Organized smuggling is the routine transportation of cigarettes between states for illegal resale. These activities range in size from one-man part-time operations to large scale business. In many instances persons who begin as casual smugglers are lured by the high profits and low risk into expanding their activities to this level. Organized smuggling began in 1965 with the small time entrepreneur who traveled to a low tax state and purchased a relatively large quantity of cigarettes, 100-500 cartons, for eventual resale in his home state. A person who could sell 500 cartons of

[1] Advisory Commission on Intergovernmental Relations, *Cigarette Bootlegging: A State and Federal Responsibility*, May 1977, p . 62.

Table 7. *Per Capita Sales for Selected Years in Massachusetts, New Hampshire and Vermont*

State	*1950*	*1955*	*1960*	*1965*	*1967*	*1969*	*1971*	*1973*	*1975*	*1977*	*1979*
Massachusetts	109.2	117	131.1	136.5	130.2	129.7	121.4	121.2	126.1	118.9	118.2
	(5)[1]	(5)	(6)	(8)[2]	(10)	(12)[2]	(16)[2]	(16)	(16)	(21)	(21)
New Hampshire	178.4	162.7	190.2	233.8	279.9	248.5	278	279	269.1	278.8	254.6
	(2.5)	(3)	(3.5)	(3.5)	(4.5)	(7)	(8.5)	(11)	(11)	(12)	(12)
Vermont	131.1	122.2	122.8	122.9	127.4	134.6	124.4	146.8	155.5	169.4	160.9
	(4)	(4)	(7)	(8)	(10)	(12)[2]	(12)	(12)	(12)	(12)	(12)
National	110	108.3	123.8	126.8	125.3	121.1	121.9	126.3	130.9	133.6	132

[1] Parenthesized figures indicate cents tax per pack for the respective years.

[2] Indicates that the rate shown became effective after the beginning of the fiscal year.

Source: Massachusetts Legislative Research Bureau from data in the *Tax Burden on Tobacco.*

cigarettes per week at a profit of 70c[1] per carton could realize more than 18,000 tax-free dollars per annum from his operation. At this scale, the person financing the operation would also be involved in the purchase, transport, and resale of the cigarettes. As these operations became more extensive and profitable, organized crime was attracted thereto.

Cigarette smuggling was ideally suited for organized crime involvement. By purchasing and transporting large quantities of cigarettes, more than 60,000 cartons per truck load, large scale operators could substantially reduce costs and consequently increase profits. Small time operators could be driven out or curtailed and monopoly markets established through the use of intimidation and force. The enforcement efforts of the states were small and uncoordinated and no federal enforcement agency had jurisdiction applying to illegal over the road transport of cigarettes between states. The low level of fines and lack of prison sentences in past cases offered little in the way of a deterrent. In addition, expanded federal enforcement efforts against organized crime's more traditional sources of revenue (i.e. narcotics, extortion, counterfeiting, etc.) created a need for new sources of revenue.

New York, in particular New York City, was the first area of the country where organized crime became the dominant source of contraband cigarettes. The Fifteenth Annual Report of the Temporary Commission of Investigation (April 1973) included the following description of an organized crime cigarette smuggling operation.

> . . . As early as 1966, Anthony Granata was known to be involved on a large scale in transporting and selling untaxed cigarettes in the City and State of New York. Originally his operation was located in the Bath Beach section of Brooklyn, New York. Granata is listed by law enforcement officials as a member of the organized crime family headed by Joseph Colombo. His criminal record reflects twelve arrests, four of which were connected with cigarette bootlegging . . .
>
> Initially, Granata's operation consisted of small scale bootlegging. As the years went on, it developed into a full-sized operation. In the period from September 1966 to April 1967, Granata, based upon his own records seized by law enforcement authorities, was responsible for smuggling 1,109,920 cartons of cigarettes

[1] One half the difference in tax rates between New York City and North Carolina in 1965.

into New York State. Tax assessments against him totaling $2,422,510 were levied by State and City authorities for this period, as provided by law. They remain uncollected.

Granata operated his business on a professional level with over 30 employees. He was known to have dispatched drivers on a 6-day a week schedule to North Carolina. Orders were placed and all necessary arrangements were handled by clerical employees in New York City. More recently he also hired an "expediter" or traffic manager, stationed in North Carolina, to manage that end of his operation. Typically, drivers were paid $100 per trip and an additional $95 expense money if they were long haul drivers (all the way to North Carolina). Short haul drivers (to Pennsylvania) received $60 per trip, plus expenses. A short haul driver would be used when arrangements had been made with the North Carolina supplier to transport the loads of cigarettes to selected points in Pennsylvania. The short haul driver would meet the shipment there, transfer it to his vehicle and bring it into New York. All legal costs caused by the arrests of drivers, wherever the jurisdiction, such as lawyers fees, bail and fines, were also handled from Granata's headquarters. Fraudulent driver's licenses and other false identification were supplied. Among other devices to avoid detection, Granata constructed a truck disguised as a lumber transporter. Dummy corporations were also formed to further conceal his cigarette bootlegging business.

Intensive police surveillance of Granata, as part of an organized crime investigation, led to the discovery that two leading members of the Genovese crime family, Mario Gigante and Vincent Gigante were involved as financiers in this operation. Meetings of these three were held in which the profits of the business and "territorial rights" were discussed.

An associate of Granata's, one Robert LiSante, was called as a witness at the Commission's public hearing. In June of 1971, LiSante had been arrested in the State of New Jersey in possession of 4,560 cartons of cigarettes. The records show that he was convicted, received a suspended sentence and paid a $250 fine. Also arrested at that time was Rocco Granata, father of Anthony. In September of 1971, LiSante was again arrested by detectives of the New Jersey State Police. This time 15,000 cartons of untaxed cigarettes, as well as a tractor and trailer truck, were seized. Anthony Granata was also arrested on that occasion. LiSante is known to be an important associate of Granata, and was responsible for coordinating orders for cigarettes, their financing and delivery arrangements. When questioned at both private and public hearings with regard to the above transactions, LiSante invoked his Constitutional privilege against self-incrimination and refused to answer all questions put to him.

Another associate of Granata in the bootlegging operation was Joseph (Sam) Pontillo, also subpoenaed as a witness at the Commission's public hearing. When, as a result of law enforcement pressure, Granata was forced to move his operation to New Jersey, Pontillo became his man to see in Brooklyn. In October of 1968, Pontillo was apprehended in New Jersey in possession of 2,200 cartons of untaxed cigarettes. In April of 1969, after having left Granata's "drop" or warehouse in New Jersey in possession of 3,600 cartons of untaxed cigarettes, he was again arrested. Available criminal records showed that this case was dismissed on the grounds of illegal search and seizure.

At the time of the Commission's public hearing, it was believed that Pontillo, on his own, had become the head of a group that was bootlegging cigarettes. His connection with Granata, as was the case with many major bootleggers, was that they shared loads of bootleg cigarettes. This enabled each bootlegger to minimize his financial risk. For example, instead of one man having to raise the capital and take the risk for 15,000 cartons of cigarettes, three operators would pool their interests, each underwriting 5,000 cartons. At both the Commission's private and public hearings, Pontillo availed himself of his Constitutional privilege against self-incrimination and refused to answer any questions.

As recently as October 15, 1971, an employee of Granata's operation was seized in New Jersey in the possession of 11,010 cartons of untaxed cigarettes.

By means of a chart prepared by the Commission and introduced as Exhibit number 22 at the hearing, it was shown that there were at least 30 individuals involved in the Granata cigarette bootlegging operation. It is interesting to note that the criminal records of these 30 individuals showed that they had a total of 189 separate arrests for various criminal acts committed by them. Of this number, 41 arrests were for cigarette tax violations. The other crimes ran the complete gamut of criminal activity. With regard to dispositions, the following is of interest:

"THE CHAIRMAN: Are there any convictions, Mr. Kelly, on the cigarette charges, on the 41 cigarette arrests? Have there been any convictions?"

"MR. KELLY: There have been a few sir, of lower echelon people. In this particular operation, as in most operations connected with organized crime, the people at the higher levels manage to insulate themselves sufficiently so they are never — or very rarely, at least — on the scene when anything is taking place or when a seizure is taking place. When a seizure does happen to take place, almost invariably the charge is dismissed based upon illegal search and seizure."[1]

This case study is illustrative of a number of changes which oc-

[1] *Fifteenth Annual Report of the Temporary Commission of Investigation of the State of New York,* April 1973, pp. 94-96.

curred in cigarette bootlegging techniques following the entrance of organized crime elements. The most obvious is the large scale and well organized nature of the operations. A second is the involvement of, and possible cooperation between, a number of organized crime families. Mr. Edgar N. Best, Inspector and Deputy Assistant Director of the Federal Bureau of Investigation, addressed this issue during testimony before a Congressional subcommittee:[1]

> I think that one interesting fact has come to our attention, that cigarette smuggling is so lucrative that all families have taken a role in it, which to some extent, is unusual in that they normally will have jurisdictional boundaries as to the type of crime activity they are involved in. But we have seen representation of a number of crime families involved in cigarette smuggling.

A third change implied by the case study is the ability of people in the higher echelons of bootlegging operations to insulate themselves from the reach of law enforcement agents. This is accomplished by the employment of persons who serve as buffers between the organizers of these enterprises and each point in the distribution chain. Such individuals have only a rudimentary knowledge of the mechanics of the total operation and if arrested can do little damage. For example: drivers are often told no more than the origin and destination of each shipment and have no involvement in the acquisition or disposal of their loads. The fact that the majority of individuals apprehended in the past either fall into this category, or were small-time operators, has contributed to the courts' reticence in imposing maximum penalties. It can also be expected to influence future sentencing.

It has been suggested that organized crime may currently be pursuing a policy of vertical integration in order to insure sources of supply. This is accomplished either by acquiring a controlling interest in, or the cooperation of, legitimate cigarette wholesalers. Access to a wholesaler's stock provides a means of diverting substantial portions of legitimate cigarette shipments into the bootleg market. The Interest Revenue Research Center has commented on this development in the following terms:[2]

> Wholesalers and other supply sources servicing the smugglers employ various acts of deception to protect and sustain a privileged relationship with the smugglers. These acts include engaging in counter-surveillance operations; establishing special delivery systems; supply diversion or manipulation; entrapment schemes designed to provoke unwarranted arrest by law enforcement activities; inflated or dummy invoices to legitimate customers for the purpose of concealing sales to the smugglers and other questionable business practices.

[1] Hearings before the Subcommittee on Crime of the Committee on the Judiciary, House of Representatives, March 8, 1978, p. 114.
[2] *Ibid,* p. 140.

Such arrangements are especially valuable to bootlegging operations which are involved in the counterfeiting of tax indicia. The wholesaler simply runs his cigarette tax stamp machines without placing any cigarettes under them. The state where the wholesaler operates receives its tax revenue and, in the absence of any evidence to the contrary, is usually satisfied that the cigarettes were distributed in a lawful manner. Counterfeiting is the most lucrative form of cigarette tax evasion. Unlike cigarettes bearing North Carolina, Virginia, or Kentucky tax stamps which must be sold at a discount, cigarettes bearing counterfeit tax stamps may be mixed with tax-paid cigarettes at retail outlets and vending machines and sold for full price. In 1977, New York enforcement agents uncovered a counterfeiting operation that was working with several licensed wholesalers and dealers. A raid on this operation netted three tax stamp counterfeiting machines, several tax stamp metering machines, and 50,000 cartons of cigarettes. Evidence of complicity between counterfeiters and legitimate businesses was also revealed in a 1976 warehouse raid by Florida enforcement agents. This raid of a licensed cigarette wholesaler resulted in the confiscation of a large quantity of cigarettes bearing counterfeit tax stamps. A burglary had been staged at the same warehouse a year earlier and a cigarette stamp machine was stolen. The subsequent raid turned up the old machine, doctored so that its stamps could not be traced. The distributor was subsequently convicted of counterfeiting cigarette tax revenue stamps and shown to have been disposing of these cigarettes through unsuspecting retailers.

On March 20, 1980, the Massachusetts Department of Revenue and the Federal Bureau of Alcohol, Tobacco and Firearms completed a six month investigation of a cigarette stamp counterfeiting ring in the Metropolitan Boston Area. On that day, two raids in the City of Malden resulted in the seizure of approximately 1,500 cartons of contraband cigarettes. These cartons bore either counterfeit Massachusetts tax stamps or legitimate North Carolina stamps. Also seized were a counterfeit tax stamping device, several cigarette vending machines, money, and a large quantity of narcotics. A 1978 Dodge car that was used in the operation was also impounded. This operation was known to have existed for over two years and is estimated to have been costing the Commonwealth in excess of $150,000 per year in lost cigarette tax revenue. No party contacted during the course of this study suggested that any licensed cigarette wholesaler in Massachusetts was or had engaged in such activities.

New York enforcement officials have noted another change in cigarette smuggling techniques. As discussed earlier, organized crime was able to reduce costs and augment profits by purchasing and transporting large quantities of cigarettes in a single shipment. However, such methods also increased the financial loss in the event of the seizure of any given shipment. As expanded enforcement efforts became more effective, bootleggers adapted their methods to counteract these developments. This was accomplished either by reducing the size of shipments or redirecting large scale hauls so as to avoid states in which law enforcement activities were meeting with some success. The New York experience has shown that as a state strengthens its enforcement efforts, bootleggers will respond by warehousing their contraband in neighboring states and dispersing their product to the consuming state in smaller lots. As surveillance activities were stepped up on the New Jersey Turnpike, smugglers began to warehouse their goods in New Jersey and Pennsylvania.

The extent of organized crime's involvement in cigarette smuggling is undertermined. Despite the consensus of opinion that organized crime has not yet expanded into the majority of states, there is a fear that the experience of those states most affected may serve as a prototype for what can be expected to happen elsewhere. Existing evidence indicates that organized criminal enterprises are operating in several midwestern states (Ill., Ind., Mich., Minn., and Ohio). In addition to cigarette smuggling, these operations engage in a wide variety of illegal activities. Organized crime families have attained a virtual monoply over cigarette bootlegging in New York City and are also very active in Connecticut, Florida, New Jersey, and Pennsylvania. As will be discussed in chapter

seven, the involvement of organized crime in Massachusetts is uncertain. The ACIR's best estimate is that almost one-half of the total national revenue loss of approximately $400 million is a consequence of organized crime's involvement.

Mail Order Purchases

A third category of cigarette tax evasion is the use of the mails to transport cigarettes between states for the purpose of avoiding the destination state's tax. The Jenkins Act (15 U.S.C. s. 375 et seq.) was passed to prevent the use of the postal system as a means of evading state taxes upon a wide variety of goods. The Jenkins Act does not ban the transportation of nontaxed cigarettes in interstate commerce but rather attempts to eliminate the motive for same by requiring notification to the receiving state's revenue department by the vendor. Such notification is to include the names and addresses of the persons to whom cigarettes were mailed and the quantity, brand, and the date of mailing. Any person or firm failing to file the required reports is subject to a penalty of six months in jail and a fine of $1,000. In addition, a civil injunction suit to restrain future violations can be brought in the United States District Court. Because of the difficulty of ascertaining the final destination of cigarettes purchased "over the counter," the Jenkins Act has most often been applied to mail order sales.

Prior to 1967, there were no prosecutions under the Jenkins Act for cigarette tax evasion. Between 1967 and 1971, intensified efforts by federal authorities resulted in the identification of 135 firms[1] in North Carolina, which were mailing cigarettes into 37 states. New York officials estimated that 30,000 to 60,000 cartons of cigarettes were being mailed into the state each day. Because of the relatively light penalties authorized by the Jenkins Act, the Department of Justice in recent years has pursued the majority of cigarette bootlegging prosecutions under the Mail Fraud Statute (18 U.S.C. s. 1341). Limited use has also been made of the wire fraud statutes and the Racketeer Influenced and Corrupt Organizations (RICO). The table below indicates the number of prosecutions and injunctive actions instituted by the Department of Justice with regard to cigarette smuggling.

[1] Many of these firms were established and operated by residents of the high tax states.

Table 8. *Federal Prosecutions and Civil Suits re Cigarette Bootlegging*

Jenkins Act, criminal	
1974	11
1975	14
1976	2
1977	0
Jenkins Act, civil injunction	
1972	3
1973	2
1974	2
1975	0
1976	0
1977	1
Mail fraud	
1975	13[1]
1976	14
1977	4
1978 —eight pending investigations	
RICO	
1976	4
Wire fraud	
1977	1

[1] Federal cases. Twenty-eight cases were referred to the States for prosecution in 1975.

Source: Hearings before the Subcommittee on Crime of the Committee on the Judiciary House of Representatives, April 8, 1978, p. 106.

The extent to which tax evasion through mail order sales is still occurring is uncertain. Of the 27 states which responded to a survey conducted by the federal Law Enforcement Assistance Administration (LEAA) in 1976, one reported that mail order sales was its major cigarette smuggling problem and eight states answered that such activity represented their second ranking smuggling problem.

During the most recent Congressional hearings the consensus of opinion was that the magnitude of such practices has declined over the past three years. Massachusetts enforcement officials concur with this belief.

Tax-free Sales

A fourth method by which untaxed cigarettes are obtained is purchase through tax-free outlets. International points of entry, Indian reservations, and military post exchanges are the primary sources of such purchases. Problems arising from the first of these channels are concentrated in those states in close proximity to the Mexican border. Tax-free cigarette sales on Indian reservations to non-Indians are a major problem in five western states (Ida., Mont., Nev., N.M., and Wash.). In Washington, for example, 23 Indian tribes sell cartons of cigarettes for as little as $3.90 compared to the $5.44 price outside the reservation. Court decisions limiting state taxation on Indian reservations have been based largely upon Article I, section 8, clause 3 of the U. S. Constitution, which authorizes Congress to "regulate commerce with foreign nations, and among the several states, and with the Indian tribes."

According to the General Accounting Office (GAO), lost cigarette excise revenue resulting from the sale of state tax-exempt cigarettes at military stores and commissaries, post exchanges, VA hospitals, and other federal facilities totaled $101,620,882 in 1977.[1] Three states lost in excess of $10 million each (Calif., Fla., and Tex.). Twenty-two states lost more than $1 million (Ala., Ariz., Ark., Colo., Ga., Ha., Ill., Kan., La., Md., *Mass.,* Miss., N. J., N. M., N.Y., Ohio, Okla., Pa., S. C., Tex., Va., and Wash.). Losses in the remaining states ranged from $949,084 in Nebraska to $2,444 in West Virginia. Among the states, Massachusetts ranked seventh in loss volume ($3,677,593) and, aside from the three states in the $10,000,000 loss range, was surpassed only by the states of Georgia ($4.4 million), New Jersey ($4.4 million) and New York ($3.8 million). The Massachusetts Department of Revenue has expressed reservations regarding the accuracy of the GAO's estimates and places the 1979 revenue loss for Massachusetts at approximately $7 million. The proportion of this loss due to the purchase of such cigarettes by or for non-military personnel is unknown.

[1] General Accounting Office, *The Tax Status of Federal Resale Activities: Issues and Alternatives,* April 1979. It is important to note that individual state loss estimates reflect not only the number of packages of cigarettes sold by military outlets in each state, but also the respective state tax rates. As a consequence, revenue losses in the high tax states may or may not indicate a greater number of tax-free sales.

Purchases by active duty military personnel and other qualified parties,[1] while depriving the state of its excise revenue, cannot be termed tax evasion. Because such transactions occur in places having the legal status of federal instrumentalities, they are immune from state and local taxes unless Congress specifically authorizes the imposition of such taxes. For example, in 1936, Congress passed the Hayden-Cartwright Act (4 U.S.C. 104), which permitted state taxation of gasoline sold by or through federal instrumentalities for personal use. In 1940, Congress enacted the Buck Act (4 U.S.C. 105-110), which allowed state and local income and sales taxes to be collected from private persons, commercial activities, private contractors, and concessionaries doing business in exclusive federal enclaves. However, the act specifically excluded state and local taxation of transactions at post exchanges, commissaries, and stores.

The extent of illegal purchases and resale of cigarettes from military and other federal outlets is unknown. A 1976 study[2] on cigarette smuggling concluded as follows:

> Although most individual violations are minor, in some states the aggregate violations constitute a serious problem. There have also been major abuses of the PX privileges, both by customers and employees of PXs. Cases of cigarettes have been purchased from military PXs for resale to civilian customers.

Although the Department of Defense has sharply disputed the legitimacy of the methodology employed by the ACIR in reaching the following conclusion, the Commission believes it is correct.

> The higher per capita sales figures for military store patrons presented . . . suggest either that military people consume more cigarettes, on the average, than do civilians (and this mainly in high-tax states), or that some military persons are buying tax-free cigarettes for the consumption of persons other than themselves and their dependents. In the absence of any reasons to assume that the military are heavier smokers than civilians or that high taxes promote heavy smoking, it is reasonable to conclude that cigarette bootlegging is a significant problem in some states.[1]

[1] Retired military personnel, active duty reservists, dependents and widows of the above, 100% disabled veterans, and employees of the U. S. Public Health Service and the National Oceanic and Atmospheric Administration.

[2] Law Enforcement Assistance Administration, *Combatting Cigarette Smuggling,* January 1976, p. 16.

This same study included the following recommendation:

> The Commission concludes that the current exemption of on-base sales to military personnel from state and local taxation should be removed. The Commission therefore recommends that the Congress give early and favorable consideration to legislation amending the Buck Act to allow the application of state and local sales and excise (including tobacco and liquor) taxes to all military store sales in the United States.[2]

Tax specialists and other political scientists have concurred with the ACIR recommendation, and legislation to effectuate such a change has been introduced during each congressional session since 1976. The Congress, however, has rejected all such proposals.

Two recent developments may reduce the problems posed to the states by the illegal resale of cigarettes purchased from military outlets. The first is a 1978 policy change by the Veterans Administration which requires that all tobacco products be sold at the prevailing community rates.[3] The second is an increasing willingness on the part of the military to aid the states in suppressing such practices. On October 30, 1979, Commissioner of Revenue, L. Joyce Hampers, sent a letter to the Northeast Commissary Field Office in Fort Meade, Maryland, requesting that, in accordance with the long standing policy of the Department, tax-free sales of cigarettes at military installations in Massachusetts be limited to two cartons per person per week. The Department has not received any reply to this correspondence and has no knowledge regarding the extent to which this policy is being complied with.

The illegal resale of cigarettes procured through military sources has been uncovered in Massachusetts. In 1977, a joint effort by the Department of Revenue, the Attorney General's Office, State Police, and military police led to the closing of a bootlegging operation in Leominster, which involved the sale of approximately 100 cartons of cigarettes per week from the rear of a local gas station. These cigarettes were being obtained from the Fort Devens Commissary. Agents within the Department of Revenue have expressed appreciation for the excellent cooperation they have received from the military police in this and other joint investigations.

[1] Advisory Commission on Intergovernmental Relations, *State Taxation of Military Income and Store Sales,* July 1976, p. 18.

[2] *Ibid.,* p. 3.

[3] The Veterans Canteen Service sells merchandise to veterans, visitors, and employees in Veterans Administration hospitals and homes.

CHAPTER VI. FEDERAL INVOLVEMENT

Past Legislative Proposals

As cigarette smuggling grew and expanded, those states experiencing major tax losses turned to the federal government for assistance. Congressional measures designed to eliminate illicit traffic in cigarettes took two forms: (1) the "contraband" approach and (2) the imposition of a uniform federal cigarette tax. The "contraband" legislation sought to curtail cigarette smuggling by making the interstate transportation of untaxed cigarettes a federal crime.[1] Uniform tax proposals were aimed at eliminating the economic incentive for smuggling. None of the uniform tax bills has been enacted into law.

Proposals to make the transport of untaxed cigarettes across state lines a federal crime first received serious consideration in 1972. In September of that year, Subcommittee 1 of the House Committee of the Judiciary held hearings to consider the advisability of enacting such legislation. At that time, large scale smuggling operations appeared to be confined to New York, New Jersey, Pennsylvania, and Maryland. New York was the only state able to provide documentation of organized crime's involvement. Opposition to the legislation was registered by several sources. Representatives of the producing states maintained that the high tax states had created the problem by imposing inordinate and discriminatory cigarette excises. They argued that effective law enforcement requires substantial citizen support for the law and a willingness to see that law enforced. The large number of New York residents willing to purchase bootlegged cigarettes was deemed to be evidence of the lack of such a consensus among its residents. Opponents of the legislation also noted that inadequate penalties and law enforcement efforts in the states most affected by cigarette smuggling showed insufficient efforts by the high tax states in their own behalf. Spokesmen for the opposition contended that additional state legislative action, improved state enforcement, and better coordination and cooperation among

[1] As noted earlier, the Jenkins Act, while providing federal jurisdiction over interstate movement of untaxed cigarettes, was of limited use in addressing the practice of over the road transport.

the states were needed to resolve the issue.

Federal law enforcement officials expressed concern over the policy implications of requiring their agencies to divert some of their limited resources and attention from such critical areas as narcotics and firearms control. While conceding that cigarette smuggling was a serious problem in several states, Department of Justice officials testified that there was insufficient evidence to conclude that organized crime's involvement had extended beyond New York. Citing a recent evaluation[1] of both New York State and New York City enforcement activity which found them to be totally ineffective, the Department of Justice took the position that an expansion of federal criminal jurisdiction into this area was not warranted. The Department also expressed concern that federal intervention might lead to a relaxation of state action and result in the abdication of state tax enforcement responsibilities to the federal government. In light of these objections and the lack of broad base support, the Congress declined to pass the legislation.

Though unable to generate a favorable response from Congress to their requests, state officials were successful in influencing the federal government to provide assistance in the form of grants from the Law Enforcement Assistance Administration (LEAA). A partial listing of these grants includes:

1. $182,436 to North Carolina's Bureau of Intelligence to develop organized crime intelligence capabilities.
2. $268,197 to the New York Department of Taxation and Finance for the purpose of creating an anti-bootlegging cigarette task force.
3. $285,552 to the State of New York's Division of Criminal Justice Services to establish within the New York City Police Department a special investigative unit devoted exclusively to the elimination of organized criminal activities associated with cigarette bootlegging.

Public Law 95-575

Congressional hearings relative to federal involvement in sup-

[1] *Fifteenth Annual Report of the Temporary Commission of Investigation of the State of New York,* April 1973.

pressing cigarette smuggling were next held in 1977 and 1978. Although a number of bills dealing with cigarette tax evasion were introduced in the intervening years, none reached the committee hearing stage. The renewed interest in federal involvement is attributable to a number of factors. Foremost is the publication of the Advisory Commission on Intergovernmental Relations (ACIR) report titled *Cigarette Bootlegging: A State And Federal Responsibility* in May 1977. This document contained the first comprehensive estimates of the revenue losses and gains being experienced on a national basis. It also provided significant insights into the true costs, and nature of, cigarette smuggling. Other important factors were (1) the release of a study and a further survey sponsored by the LEAA[1] (both of which concluded that cigarette tax evasion was a national problem), (2) increasing evidence of organized crime involvement, and (3) an upsurge in media attention to the subject.

On the final day of the Second Session of the 95th Congress, with the enactment of Senate, No. 1487, the first major step was taken to provide federal assistance in curtailing over the road transport of contraband cigarettes (P.L. 95-575; 18 U.S.C. c. 114). The possession and/or transportation of contraband cigarettes across state lines became a federal crime. Responsibility for the implementation of the law was delegated to the Bureau of Alcohol, Tobacco and Firearms (ATF) within the Department of Treasury.

The Congress enacted the legislation in response to its findings that:

1. the states were not able to adequately address the problems posed by widespread traffic in untaxed cigarettes;
2. there is a "casual relationship" between the illegal transport and resale of cigarettes between states and the rise of racketeering in the United States;
3. organized crime was realizing hundreds of millions of dollars in profits and financing other illicit activities through its involvement in cigarette smuggling;

[1] Law Enforcement Assistance Administration, *Combatting Cigarette Smuggling,* January 1976.

4. a sharply expanded federal role in curtailing cigarette smuggling was necessitated by virtue of the interstate nature of the problem; and
5. record-keeping requirements for dealers in cigarettes would have a high degree of usefulness in criminal, tax, and regulatory investigations.

Public Law 95-575 defines the term "contraband cigarettes" as a quantity of more than 60,000 cigarettes (300 cartons) which bear no evidence of the applicable state excise tax having been paid. Cigarettes are not considered contraband if found in the possession of (a) any person licensed as a tobacco manufacturer or as an export warehouse proprietor, a common or contract carrier, or operator of a U. S. Customs bonded warehouse, (b) a person licensed by the state in which the cigarettes are found, to deal in cigarettes and act as a state stamping agent, and (c) federal or state officers engaged in official business. The law provides that it shall be unlawful for any person to knowingly ship, transport, receive, possess, sell, distribute, or purchase such contraband. Further, it shall be illegal for any person who ships, sells, or distributes any quantity of cigarettes in excess of 60,000 cigarettes in a single transaction to misrepresent or falsify information required by the record-keeping provisions of the law. Although the legislation authorized the Secretary of the Treasury to require certain records pertaining to the disposition of quantities of cigarettes in excess of 300 cartons in a single transaction, no Treasury regulations governing this action have been adopted to date.

The maximum penalty for conviction of "the possession of, or trafficking in, contraband cigarettes" is a $100,000 fine or five years in prison, or both. Violators of the record keeping requirements are subject to a fine of up to $5,000 and imprisonment of three years. Although the law authorizes the ATF to seize contraband cigarettes and the vehicles used to transport them, the Bureau's policy has been to allow state enforcement agents to take possession when authorized to do so by state statutes. Known as the "split seizure concept", this practice allows the states to sell the cigarettes and vehicles to recoup a portion of the lost tax revenues.

The enactment of P.L. 95-575 was supported by the Carter Administration, the National Governors Association, the National Association of Tax Administrators, the National Tobacco Tax Association, the ACIR, the Tobacco Tax Council, the National Association of Tobacco Distributors, and numerous state enforcement officials and organizations. The Justice Department also supported the passage of federal "contraband" legislation but reiterated its concern that the states were not making sufficient efforts in their own behalf.

During the recent congressional hearings the organized smuggling of large quantities of nontaxed cigarettes by major crime groups was attacked as the root problem.[1] Proponents argued that the failure of the federal government to take concerted action in the past enabled organized crime to gain a foothold that would not otherwise have been possible. Law enforcement officials and/or tax administrators from Connecticut, Florida, New Jersey, New York, and Pennsylvania testified that large scale cigarette bootlegging enterprises were operating in their states. The infiltration and takeover of bootlegging operations by organized crime changed the situation from a problem in a few isolated states to a matter of national concern. Moreover, advocates of the pending legislation emphasized that the interstate nature of the crime and the interplay of constitutional issues in respect to the exercise of apprehension and arrest powers in interstate commerce by local and state authorities hampered state enforcement action. As noted by an LEAA report on the subject, a smuggler's maximum vulnerability is during shipment when arrest can result in seizure of both the cargo and the vehicle. Since state enforcement action generally begins after the shipment has been divided and distributed, not only is detection infinitely more complex but also the deterrent effect is reduced because the criminal's potential financial loss is less.[2] Past attempts by state enforcement officials to track trucks

[1] Hearings before (a) Subcommittee on Criminal Laws and Procedures of the Committee on the Judiciary, U. S. Senate, October 21, 1977; (b) Subcommittee on Crime of the Committee on the Judiciary, House of Representatives, February 28, March 8, and April 19, 1978; and (c) Subcommittee on Miscellaneous Revenue Measures of the Committee on Ways and Means, House of Representatives, March 21, 1978.

[2] Law Enforcement Assistance Administration, *Combatting Cigarette Smuggling,* January 1976.

loaded with cigarettes purchased in North Carolina have been frustrated by bootleggers' diversionary tactics before they reach the jurisdictions in which officials have the authority to make arrests. The new federal "contraband" law eliminates this problem by allowing seizure at the first state line that is crossed.

Because of its recent origin, the effectiveness of the federal "contraband" law cannot be determined. Between October 1, 1978 and September 30, 1979, the AFT expended 17,082 man-days on the enforcement of the contraband cigarette law. ATF agents participated in the arrests of 29 individuals who were charged with violations of federal statutes. Joint operations by ATF, state, and local authorities resulted in the seizure of 26,075 cartons of contraband cigarettes and the confiscation of 15 motor vehicles. The average size of the contraband cigarette seizures in which the ATF was involved was approximately 1,185 cartons. Listed below are summaries of these investigations.[1]

Washington, D.C.

On April 4, 1979, a suspect was arrested by ATF and Washington, DC police officers for possession of 5,430 cartons of contraband cigarettes, having Virginia tax stamps affixed. On August 21, 1979, the defendant was convicted in U. S. District Court, Washington, DC for violation of 18 U. S. C. Chapter 114, "Trafficking in Contraband Cigarettes". Sentencing is pending.

Worcester, Massachusetts

On April 27, 1979, ATF special agents assisted by State police arrested two suspects and 414 cartons of contraband cigarettes were seized. These cigarettes bore North Carolina and New Hampshire tax stamps. The potential tax loss to the State of Massachusetts was estimated at $1,117.

On July 24, 1979, and August 13, 1979, the two defendants pled guilty to Title 18 U. S. C. Chapter 114 in U. S. District Court in Boston, Massachusetts.

On August 14, 1979, one of these defendants was sentenced to one year of confinement, suspended, two years probation, and $1,000 fine. The other sentence is pending.

[1] Correspondence from William H. Richardson, Assistant Director, Criminal Enforcement, Bureau of Alcohol, Tobacco and Firearms to Daniel M. O'Sullivan, Director, Massachusetts Legislative Research Bureau, March 11, 1980.

Miami, Florida

In July, 1979, Florida State Beverage agents, assisted by ATF arrested an individual in Highlands County for violations of the State contraband cigarette laws. Forty-one cartons of cigarettes were seized from the subject's vehicle, in addition to 47 cartons seized from the subject's residence, all bearing North Carolina tax stamps. The investigation revealed that he had been engaged in cigarette smuggling since 1977.

Englishtown, New Jersey

On August 9, 1979, ATF agents and State Treasury agents seized 704 cartons of North Carolina tax stamped cigarettes along with a suspect's vehicle. State agents arrested the suspect for violation of New Jersey contraband cigarette statute.

On September 4, 1979, the defendant pled guilty in New Jersey to possession and transport of untaxed cigarettes. The defendant was sentenced to 30 days incarceration and $1,500 fine. The vehicle, which was utilized to smuggle the contraband cigarettes, was forfeited to the State of New Jersey.

New York, New York

On August 14, 1979, a total of 2,006 cartons of cigarettes bearing North Carolina tax stamps were seized by ATF agents with State and local authorities.

Cleveland, Ohio

On August 27, 1979, ATF special agents working in conjunction with the Ohio Department of Taxation seized a small quantity of cigarettes from a contraband cigarette dealer.

Chicago, Illinois

On September 7, 1979, Chicago ATF agents seized 1,140 cartons of contraband cigarettes bearing North Carolina tax stamps.

Richmond, Virginia

On September 7, 1979, ATF agents, along with officers from the Richmond Police Department, Chesterfield County Police Department, and security personnel from Philip Morris, Inc., arrested 4 individuals and seized 360 cartons of cigarettes which had been stolen from Philip Morris. The subjects were charged with violations of Virginia State law. This is the first case which was investigated in conjunction with tobacco industry personnel.

Houston, Texas

On September 20, 1979, near Livingston, Texas, a Texas State trooper arrested an individual. A search of the vehicle revealed 373 cartons of cigarettes bearing no tax stamp. ATF was immediately contacted for assistance. The individual was a six time convicted felon.

A National Uniform Cigarette Tax

As noted earlier, a second approach to reducing the incidence of cigarette smuggling is to eliminate the economic incentive for such activities. Such a result requires either the complete elimination of, or a sharp reduction in, the existing disparities in state cigarette excises. This can be achieved either by cooperative efforts among the states or by the imposition by the federal government of a uniform national tax. Differing revenue needs, attitudes towards smoking, and economic interests in tobacco production are likely to preclude the first option. As a consequence, a number of proposals have been advanced over the years which sought the enactment of federal legislation to provide the necessary incentives for the states to narrow the range of their cigarette taxes.

Although the uniform tax approach has generally been dismissed as politically impossible in the past, the House Ways and Means Subcommittee on Miscellaneous Revenue Measures held hearings on several bills in 1978 which would have replaced individual state taxes with a uniform federal tax on cigarettes. Because the states could be mandated to vacate the cigarette tax filed only by an amendment to the constitution, uniform tax proposals must be drawn in terms which are attractive to all states. Thus, uniform rates must be high enough to insure that no state, or only a few, experience revenue losses. Essential to such legislation is a so-called hold harmless clause which would guarantee that every state receive a level of revenue equal to that produced by the respective states' taxes. Each of the uniform tax bills filed in 1978 included such a clause.

Proponents of a uniform tax contend that it is the only means of eliminating all forms of cigarette tax evasion. They argue further that, unlike the "contraband" approach which requires increased expenditures for enforcement efforts, the tax equalization approach could be implemented at a relatively low administrative cost by utilizing the existing federal system for collecting the federal tobacco excise. The only additional cost would be that of distributing the tax proceeds to the states.

The major arguments advanced in opposition to the proposed legislation were:

1. Its enactment would deprive the states of the right to impose a tax which they are constitutionally permitted to impose.
2. It would restrict the states' ability to use the cigarette excise as a source of marginal revenue by requiring congressional action to change the rate.
3. Determining a rate which would be acceptable to all states, and a distribution formula which would not deprive some states of revenue while enriching others, poses difficulties.
4. Without state cigarette taxes it would be impossible to determine the level of consumption in each state.
5. The proposals fail to address the status of local cigarette taxes.

Reduced State Cigarette Excise

Both the recently enacted federal "contraband" law and the uniform tax proposals developed from a determination that the states were either unable or unwilling to resolve the problem of cigarette smuggling by themselves. The same factors which gave rise to the wide disparities in tax rates among the states continue to operate and re-enforce the economic incentive for some states to maintain the disparities. The producing states believe that the potential revenue sacrificed by their low excises is more than compensated for by the contributions of tobacco to their state economy. These and other low tax states all benefit from the large volume of sales to non-residents. According to the ACIR, total revenue losses resulting from cigarette smuggling was almost $400 million in 1975. These losses translate into large revenue gains for the states in which these cigarettes are purchased. Seven states were calculated to have realized significant revenue gains: New Hampshire, Kentucky, North Carolina, Vermont, Indiana, Virginia, and Oregon. In addition to increased tax revenue, these states also benefit by effectively exporting part of the state tax burden to the residents of

other states. In light of the above, it is doubtful that these states will raise their rates significantly in the near future. The same fiscal pressures and attitudes towards smoking that lead to the high tax states' present tax policies towards cigarettes will probably increase in the future.

The ease with which contraband cigarettes can be acquired, transported, and resold has severely hampered the effectiveness of state law enforcement efforts. In addition, it is difficult for state revenue departments to justify large increases in cigarette tax enforcement expenditures which raise the cost of administering this tax far in excess of other state taxes. Further, the magnitude of policing efforts necessary to completely eliminate cigarette smuggling exceeds the capabilities of both the states and federal governments. The consensus of opinion at the time of its enactment was that the "contraband" bill would be no more than 30 percent effective. It was also widely acknowledged that while increased enforcement efforts and statutory penalties were necessary to reduce smuggling, it cannot be eliminated without a dramatic decrease in the tax disparities among the states. Mr. Morris Weintraub, Director of the Council Against Cigaret (sic) Bootlegging, made the following statement to the House Committee on the Judiciary in 1972:

> Enforcement alone, unless coupled with a reasonable rate of cigarette taxation, has never been and never will be an effective solution to the bootlegging problem.

In addition to its endorsement of the federal "contraband" law, the ACIR also recommended that Congress monitor the states' efforts to reduce the disparity in their tax rates. The Commission's report stresses that the high tax states should realize that further increases in their tax rates by increasing potential profits will lead to even greater organized crime involvement.

Although proposals calling for a decrease in the cigarette excises of the high tax states have not received broad based support, at least two such proposals are noteworthy because of their source. In March of 1976, New York Commissioner of Taxation and Finance James H. Tully directed that a special task force be created to investigate the problem of cigarette smuggling. In its second report of December 1976, the Task Force recommended that the 8c New York City tax be repealed and that the New York State tax be reduced 1c to 14c.[1] Reasoning that taxes were currently being collected on only a portion of the cigarettes sold in the state, the task force argued that New York would actually experience a revenue gain from such actions. This recommendation has also been endorsed by members of the state's tobacco industry and the New York Times. A tax decrease has also been recommended by the Florida House Select Committee on Organized Crime. Following an 18-month study of organized crime activities within the state, the committee recommended that Florida's cigarette tax be reduced by 2c to 15c.[2] This decrease would not only aid in reducing illegal sales but would also help to stem the growth of organized crime within the state. Neither of the above recommendations has been acted upon by the respective state's legislators.

Arguments in favor of a tax decrease in Massachusetts are as follows:

1. It would reduce both the incentive for Massachusetts residents to purchase their cigarettes in neighboring states and the profits of organized crime.

2. Although organized crime does not appear to have become as heavily involved in cigarette smuggling in Massachusetts as some other Northeast states, the incentive is there. Massachusetts may well become even more attractive to organized crime as other states increase their enforcement efforts.

3. Massachusetts retailers and wholesalers are experiencing significant losses due to purchases of contraband cigarettes and purchases in other states. Further, these losses are most serious for retailers and wholesalers whose market area is in close proximity to the bordering states, New Hampshire and Vermont in particular.

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[1] The New York State Special Task Force on Cigarette Bootlegging and the Cigarette Tax, *Second Report,* December 1976, p. 5.

[2] Florida House of Representatives Select Committee on Organized Crime, *Final Report,* June 30, 1978, p. 61.

CHAPTER VII. CIGARETTE TAX EVASION IN MASSACHUSETTS

Relevant Statutory Provisions

Responsibility for the administration, collection, and enforcement of the Massachusetts cigarette tax is vested in the Department of Revenue. These functions are carried out by two units within the Division of Audit. Licensing, tax collection, and record auditing are performed by the Audit Bureau. Investigations and enforcement activities related to criminal evasion have been delegated to the Cigarette Enforcement Unit within the Special Intelligence Unit.

In Fiscal 1979, cigarette excise tax collections totaled $142,271,947.

Massachusetts laws pertaining to the sale and taxation of cigarettes appear in Chapters 62C and 64C of the General Laws. Chapter 62C authorizes the Commissioner of Revenue to: (1) adopt regulations governing the maintenance of records and reporting procedures; (2) impose penalties for the failure to submit required reports or for the filing of incorrect returns; (3) make determinations regarding applications for abatement of taxes; (4) establish bonding requirements for persons licensed to deal in, or transport, cigarettes; (5) set licensing requirements for the same; (6) suspend or revoke such licenses; and (7) hold hearings, issue summonses, and require the attendance and testimony of witnesses on matters related to the administration and collection of the cigarette excise tax.

Chapter 64C of the General Laws (1) defines the various categories of individuals authorized to deal in cigarettes; (2) proscribes the record-keeping and statement requirements which apply to such parties; (3) prohibits the use of any device or game of chance to promote or induce cigarette sales; (4) specifies the manner in which the state excise is to be paid and administered; (5) prohibits sales to minors; and (6) defines and prohibits unfair sales practices. This chapter also contains provisions relative to (a) illegal sales and activities and (b) penalties for violations. Specifically, Chapter 64C, section 8, authorizes any state or local enforcement agent to arrest, without a warrant, any person discovered in the act of illegally transporting, delivering, or possessing contraband cigarettes and to seize any cigarettes, vending machines, containers, records, and vehicles in possession of such person or persons. Such vehicles, containers, and cigarettes shall be forfeited to the state and proceedings shall be held as provided in sections 50-55 inclusive of Chapter 138. Section 34 of Chapter 64C stipulates that the possession of unstamped cigarettes by an unauthorized party shall be prima facie evidence of intent to sell. The section also provides for a fine of not more than $1,000 and/or imprisonment for not more than one year upon conviction. Section 35 prohibits the transport of untaxed cigarettes by unauthorized persons and provides for the confiscation of the cigarettes, containers, records, and vehicles used for illegal transport. Maximum fines of $1,000 and/or maximum sentences of one year await persons convicted under this statute. Under Section 36, the inability of any person found to be transporting untaxed cigarettes to produce the required invoices or delivery tickets shall be prima facie evidence that such person knowingly possessed, delivered, or transported unstamped cigarettes. Lastly, Section 37 provides that any person convicted for possessing or distributing forged or altered cigarette excise stamps or excise stamp devices shall be punished by a fine of not more than $2,000 or by imprisonment up to five years, or both.

Enforcement Efforts

Prior to 1976, the Department of Revenue devoted limited resources, manpower, and effort to the investigation of cigarette bootlegging in Massachusetts. Three tax administrators, none of whom had any formal training or practical experience in criminal investigations, were assigned this function, in addition to their administrative and collection duties, and other responsibilities. In 1975, Massachusetts revenue agents in conjunction with local and state police arrested four persons for offenses related to cigarette smuggling. A total of 3,000 cartons of contraband cigarettes were seized. According to the ACIR, almost 6,000,000 cartons of cigarettes on which the Massachusetts excise tax had not been paid were consumed by Massachusetts residents in 1975.

In November of 1975, the Attorney General joined with the Department of Revenue in a joint effort against cigarette smuggling in Massachusetts. This operation was initiated in response to evidence of increasing organized crime involvement in states such as New York and New Jersey, as well as a growing recognition of the revenue losses being experienced by the state. Over the next 18 months, joint investigations were conducted by the three revenue agents and one investigator from the Atorney General's office. These efforts were supplemented by occasional assistance from State Police personnel. By April of 1977, when this formal program of joint investigations was terminated, 20 individuals had been arrested and convicted of some form of cigarette tax evasion. Generally, the defendants received minor fines; none received prison terms. Seven vehicles were seized, three of which were ultimately forfeited to the state. Five thousand cartons of contraband cigarettes were impounded and, when sold, realized $12,500, which was paid to the General Fund. Persons involved in the investigations estimate that these efforts eliminated smuggling operations which were costing the state $1 million in lost revenue and generating $600,000 in illegal profits.

With the termination of the formal program of joint investigations in April of 1977, sole responsibility for initiating investigations of cigarette smuggling activities reverted to the Department of Revenue. Although the Attorney General has maintained an interest in smuggling operations involving evidence of possible organized crime involvement, it has not actively participated in surveillance and investigatory activities since the cessation of the joint operation.

In July of 1979, the enforcement efforts of the Department of Revenue were reorganized and assigned to a special unit, the Cigarette Enforcement Unit, within the Department's Special Intelligence Bureau.[1] This section currently consists of one supervisor, five investigators, and one secretarial position. As of March 1, 1980, this unit has conducted 14 investigations resulting in either state or federal prosecution of 17 individuals. Three vehicles have been seized and 1,850 cartons of cigarettes confiscated. Twelve of these investigations were conducted either jointly or with the cooperation of the Bureau of Alcohol, Tobacco and Firearms.

The majority of investigations conducted by this unit are initiated in response to information supplied by local and state police. Additional intelligence results from plea-bargaining arrangements

[1] No records exist of the number of investigations, arrests, or seizures which occurred between April of 1977 and July of 1979.

by local district attorneys and the Attorney General. Eliciting the aid of local police departments is a crucial component of the Cigarette Enforcement Unit's enforcement program. To increase the level of intelligence provided by local police departments, the Department of Revenue has recently circulated a letter to all police departments in the state, informing them of the existence of the Cigarette Enforcement Unit and encouraging them to report any evidence of cigarette smuggling to the Department. Revenue officials are also considering holding symposiums and training sessions for local police in order to acquaint them with the investigatory techniques employed to uncover the existence of cigarette smuggling as well as to impress upon them the seriousness of this form of tax evasion.

Tax Evasion Methods

The relative magnitude and extent of the various forms of cigarette tax evasion which occur in Massachusetts is unknown. Past estimates by state enforcement officials have attributed as much as 50 percent of the bootlegging conducted in the state to organized crime elements. The present supervisor of the Cigarette Enforcement Unit, Mr. Fred L. Colbert,[1] declined to speculate as to the proportion of lost tax revenue which is attributable to casual versus organized crime smuggling. He noted that definitions of organized smuggling vary and that a distinction is necessary. All of the smuggling operations investigated by his unit are organized criminal enterprises. That is, they engage in activities resulting in relatively large losses of cigarette tax revenue on a routine basis. He believes that numerous such operations may be active in the state.

Another form of organized smuggling is the large scale criminal syndicate which operates on a national, regional, or statewide basis and derives its support from a wide range of illicit activities including drug traffic, extortion, prostitution, gambling, etc. In some states, notably New York, there is convincing evidence that criminal syndicates have become involved in cigarette smuggling. New York state and city officials believe that organized crime has achieved a virtual monopoly of illegal cigarette traffic in New York

[1] Prior to his employment by the Department of Revenue, Mr. Colbert was an investigator in the Massachusetts Attorney General's Office and served as the Attorney General's representative in the joint efforts noted earlier.

City. The extent to which this form of organized crime involvement in cigarette bootlegging has developed or spread to Massachusetts is uncertain. Intelligence collected in the course of investigations by enforcement agents in Massachusetts and other states has led those privy to the reports to conclude that it is a factor. At least one known organized crime figure from Massachusetts is presently residing in North Carolina and is believed to be involved in cigarette smuggling. Other evidence indicating the intrusion of organized crime into cigarette smuggling is the appearance of cigarette packages bearing counterfeit tax indicia at retail outlets. Mr. Colbert notes that sufficient quantities of counterfeit stamped cigarettes have been discovered to indicate the presence of highly organized and potentially large scale cigarette bootlegging operations.

On March 20, 1980, the Department of Revenue and the federal Bureau of Alcohol, Tobacco and Firearms completed a six-month investigation of a cigarette stamp counterfeiting ring in the Boston Metropolitan Area. On that day, two raids in the City of Malden resulted in the seizure of approximately 1,500 cartons ($5,250) of contraband cigarettes. These cartons bore either counterfeit Massachusetts tax stamps or legitimate North Carolina stamps. Also seized were a counterfeit tax stamping device, several cigarette vending machines, money, and a large quantity of narcotics. A 1978 Dodge van that was used in the operation was also impounded. This operation was known to have existed for over two years and is estimated to have been costing the Commonwealth in excess of $150,000 per year in lost cigarette tax revenue.

Two other indicators of large scale organized crime involvement are seizures of large quantities of bootleg cigarettes and the incidence of cigarette shipment hijackings. The largest quantity of cigarettes seized at a single time by Massachusetts enforcement agents is 1,500 cartons. The seizure of large quantities of cigarettes in single shipments is presumed to be sufficient evidence of syndicate backing because of the great expense entailed by purchases of this magnitude. For example, a tractor trailor load of 60,000 cartons purchased in North Carolina represents an investment of $210,000 ($3.50/carton).

Comprehensive data regarding the incidence of cigarette shipment hijacking in Massachusetts is unavailable. Neither the State Police nor the Department of Revenue maintains files which record the number of cigarette hijackings which occur in any given year. The only source from which the Bureau was able to obtain any information was the New England Transportation Security Council of Massachusetts. As noted by the Council's President, Mr. L. B. Morash, the Council's reports are derived from information provided by a newspaper clipping service and may contain a significant number of omissions. A review of the Council's reports for the past three years reveals only six cigarette hijackings over the entire period.[1] Four occurred in 1977 and two in 1978. Despite the low number of hijackings that have taken place in the past, those Massachusetts trucking firms which handle a large volume of cigarettes have felt it necessary to install expensive electronic alarm systems and assign extra, and in some instances, armed men to certain shipments. They have also experienced major increases in the cost of theft insurance.

Using cigarette shipment hijackings as an indicator of organized crime involvement in cigarette smuggling is questionable. Those who defend its use contend that hijackings reflect the fact that a distribution system for disposing of contraband cigarettes is already in place. Proponents of this view believe that cigarette shipment hijackings offer an even more profitable alternative than the purchase of cigarettes in the low tax states. Reservations regarding the legitimacy of these claims center around the fact that the operators of large scale and well-established bootlegging operations may have more to lose than gain by engaging in such activities. In contrast to the low level of enforcement activities devoted to stemming traditional bootlegging activities, truck hijackings generate a great deal of investigatory activity by state and local police as well as possible FBI involvement. This side argues that cigarettes are hijacked because they are a valuable commodity which can be easily disposed of and as such are not unlike televisions, razor blades, liquor, and other commodities more commonly waylaid.

Enforcement Problems

Until recently there were only three investigators and one supervisor who worked full time on cigarette tax evasion. Recognizing the inability of such a small enforcement unit to provide a strong

[1] The 1979 reports cover only the first nine months of the year.

deterrent to cigarette tax evaders, the Department of Revenue has augmented the unit with two additional investigators. Another factor hindering the existing Cigarette Enforcement Unit's efforts is the unavailability of state cars for use by its personnel. At present, the unit's investigators are forced to use their own cars. This allows parties under surveillance the opportunity to record and check license plate numbers and consequently exposes both the investigators and their families to undue personal risk. It also means that potential unit employees must have an automobile for use in the conduct of their official duties. Although Chapter 64C, section 8 of the General Laws provides for the seizure and ultimate confiscation of vehicles used for the illegal transportation of untaxed cigarettes, the unit has been unsuccessful in securing any of the vehicles seized in past raids. Judges have either been unwilling to subject those convicted to the financial hardship entailed by such a loss, or the existence of liens on the automobile, or the bootlegger's use of rental vehicles, has precluded this option. Mr. Colbert advises that the State Police have five mobile unit radios which they would provide and install if the unit gets state cars.

Among other problems, the inability to maintain radio contact between state agents and ATF personnel has hampered the coordination of state and federal investigations. Investigators lack cameras and binoculars, both of which are considered essential for successful surveillance operations. Another difficulty experienced by the Cigarette Enforcement Unit in the past has been its lack of authority to make arrests or secure search warrants without the assistance of local or state police. In one instance, a significant seizure was jeopardized by the delays caused by this arrangement. Further, the lack of authority to make arrests has also created difficulties in instances where joint raids by state and federal officials uncover quantities of cigarettes below that required for federal prosecution. However, this problem has been alleviated by the recent granting of special police powers to the unit's supervisor by the Commissioner of Public Safety.

Improving Enforcement Efforts

To enhance its ability to address the problem posed by cigarette smuggling, the Department of Revenue has filed legislation seeking to increase the statutory penalty for transporting, possessing or selling unstamped cigarettes, or cigarettes upon which the Massachusetts tax has not been paid. This recommendation is included in both the Department's 1980 recommendations for legislative action (House, No. 238) and House, No. 250, which accompanied the recommendations. House, No. 250 seeks to amend Section 34 of Chapter 64 of the General Laws to provide for a maximum fine of $5,000 and imprisonment for not more than five years, or both, for unauthorized individuals found to be in possession of, with intent to sell, more than 60 cartons of contraband cigarettes. Where the violation involves less than 60 cartons, the accused would be subject to a fine of not more than $1,000 or to imprisonment for not more than one year, or both. Support for this change is based upon a belief that the current penalties do not reflect the seriousness of the offense and allows smugglers to increase their volume without any corresponding increase in risk. Further, such a change will act as a stronger deterrent to such activities without any additional cost. The proposed legislation would also amend Sections 50 to 54 of G.L. c. 140 to allow the Commissioner of Revenue to conduct the sale of confiscated cigarettes, vending machines, receptacles, and/or vehicles seized from convicted persons. Present law vests such power in the Commissioner of Public Safety.

Other areas in which some members of the Department of Revenue have expressed interest are: (1) the use of informer fees; (2) the establishment of a toll-free "hot-line;" (3) eliminating the need for a court hearing prior to disposal of confiscated cigarettes; (4) the retention by the Cigarette Enforcement Unit of one-half of the proceeds realized from such sales; (5) the use of public interest media time to alert the public to the seriousness of cigarette smuggling activities; and (6) increasing industry involvement in uncovering illegal operations.

Payment for information which results in the seizure of contraband cigarettes is practiced in several states. Payment is provided for on both a per carton basis, between 25c and 50c per carton, and as a percentage of the value of the forfeited cigarettes. The head of the Cigarette Enforcement Unit believes that such a monetary inducement will significantly increase the willingness of both persons engaged in other illegal activities and members of the general public to report cigarette smuggling operations.

The Governor's Management Task Force has also endorsed the use of informer fees. Appendix L of the Task Force's recommendations (House, No. 5900) proposes that Chapter 64 of the General Laws be amended to provide for payment of between 10 and 20 percent of the value of the seized cigarettes. The specific percentage is to be determined by the presiding judge on the basis of the assistance given by such person but should not be less than $50. The establishment of a toll-free "hot-line," the use of media time, and increasing industry involvement are all aimed at supplementing traditional enforcement efforts by eliciting the aid of outside parties.

A final change which has been endorsed by the Department of Revenue is requiring that payment of the cigarette excise be evidenced only by stamps affixed to the cigarette package rather than by metered impressions. Such legislation filed by Senator Robert E. McCarthy of the Second Plymouth District and Chairman of the Joint Committee on Taxation (Senate, No. 1664). Both the Department and the Senator believe that the ink impressions used by some wholesalers in the state can be easily counterfeited. The use of stamps is also endorsed by the ATF, numerous revenue departments in other states, and the 1976 Management Task Force appointed by then Governor Michael S. Dukakis.

CHAPTER VIII. OTHER STATES' ACTION

Connecticut

A special investigation unit within the Connecticut Department of Revenue Services is responsible for enforcing the state liquor, sales, and cigarette tax statutes. This unit consists of 12 investigators, two of whom devote all their time to cigarette tax related activities. All of the agents have attended the State Police Academy and have received training in cigarette smuggling investigations. To qualify for an investigatory position, an applicant must have either a college degree or a criminal justice background. Agents have full police powers and are authorized to carry firearms. Each agent has use of an unmarked state vehicle which is equipped with a mobile radio. The state also utilizes a system whereby any attempt to identify the owner of the vehicle through a license plate check will receive a phony name and result in immediate notification of the unit that such an attempt has been made. Although Connecticut uses a "hot line" for receiving tips on fraudulent activities, it does not pay informers for intelligence which results in the seizure of contraband cigarettes.

Any person who sells or offers to sell any cigarettes which do not bear the state tax stamp is subject to, for a first offense, a fine of not less than $250 nor more than $1,000 and/or imprisonment of not more than one year. Each subsequent offense exposes the defendant to a fine of not less than $500 nor more than $2,000 and/or imprisonment of not more than one year. Conviction for sale of more than 20,000 untaxed cigarettes can result in a fine of not less than $500 nor more than $5,000 and/or imprisonment for not less than one year nor more than five years.

Connecticut's statutes provide for the confiscation of any unstamped cigarettes, the vehicle in which said cigarettes were found, and any other paraphernalia, equipment, or other tangible personal property found with the contraband cigarettes. Any property so seized may be offered by the Commissioner of Revenue for sale at public auction or disposed of in any other manner which the Commissioner believes to be in the best interest of the state. Any person claiming an interest in such property must make a written application to the Commissioner for a hearing, stating his interest in the property and his reasons why it should not be confiscated. In the absence of such a request, the Commissioner retains a small sample of the cigarettes seized and auctions off the balance. The state has generally realized approximately $4.35 per carton ($2.25 purchase price plus $2.10 excise tax) from such sales, the proceeds of which are paid into the General Fund. Any person who counterfeits any stamp prescribed by the Commissioner or tampers with any authorized metering machine shall be deemed guilty of a felony and upon conviction shall be imprisoned for a mandatory term of one year, and up to a maximum of ten years.

Maryland

In Maryland, responsibility for enforcing the state cigarette tax rests with the Alcohol and Tobacco Tax Enforcement Division of the State Comptroller's Office. This unit currently consists of 14 investigators who divide their time between alcohol and tobacco tax investigations. Investigators must possess the primary qualifications for a police officer. They have all the powers of peace officers in the performance of their duties. They are armed and each has use of an unmarked state car. Maryland resorts to paid informers and pays 20c per carton for cigarettes seized as a consequence of such tips. Maryland residents are allowed no more than two packages of cigarettes which do not bear the state tax stamp and nonresidents traveling through the state may have one carton of cigarettes in their possession. The law also provides that no person shall bring from any military installation or reservation more than two packages of cigarettes, except those entitled by law to purchase from such exchanges may have in their possession up to two cartons of such cigarettes.

Any cigarettes which do not bear the proper stamps are declared to be contraband and may be seized without a warrant. Any person transporting unstamped cigarettes who cannot produce the required invoices is tried on a felony count and, upon conviction, is subject to a fine of not more than $25 for each carton of cigarettes seized and/or imprisonment for not more than one year. In addition, such a person is liable for the tax, interest, and penalty due on the cigarettes. Any person convicted of forging, altering, or counterfeiting the state tax stamp is subject to a fine of not more than $5,000 and/or a maximum sentence of five years. Any person convicted of knowingly selling unstamped or improperly stamped cigarettes shall be guilty of a misdemeanor and fined not more than $1,000 and/or imprisoned for not more than one year. In each of these two offenses, every person may be deemed guilty of a separate offense for each and every day or any part thereof that any such violation continues.

In the absence of a written request for the return of seized cigarettes and vehicles, the Comptroller is authorized to dispose of both as follows:

(1) Cigarettes shall be sold to State institutions and to non-profit charitable institutions at a price and in a manner within the Comptroller's discretion.

(2) Confiscated vehicles shall be sold at public auction and after payment of (1) the costs of such sales and (2) any bona fide liens against the vehicles, the proceeds shall revert to the General Fund.

New Jersey

The New Jersey Division of Taxation has 18 investigators who devote the majority of their time to cigarette tax evasion. These agents are armed, have full police powers, and attend the State Police Academy. Applicants for these positions must have either a college degree or previous investigatory experience. Each agent has use of an unmarked car which is equipped with a mobile radio. New Jersey also makes use of so-called confidential license plates as was discussed above (see Connecticut). Although the state does not presently maintain a "hot line", it does place posters at numerous locations throughout the state which warn of the penalties for cigarette tax evasion. The investigatory unit also sends flyers to local police departments and sends a representative to the State Police Academy to deliver an annual lecture on cigarette smuggling techniques.

Any person who possesses unstamped cigarettes is liable to a penalty of not more than $25 for each individual carton of unstamped cigarettes in his possession. Selling cigarettes without the required stamps exposes a convicted vendor to a fine of not more than $1,000 and/or imprisonment for not more than one year. Persons found in possession of more than 2,000 but less than 20,000 unstamped cigarettes are subject to a fine of not more than $500 and/or imprisonment for a term up to six months. Persons convicted of possessing 20,000 or more untaxed cigarettes are subject to a maximum fine of $1,000 and/or imprisonment for not more than one year. Conviction for counterfeiting of tax stamps or possession of any counterfeit impression device carries a penalty of a fine of not more than $2,000 and/or imprisonment, with or without hard labor, for a term of not more than seven years. Disposal of seized cigarettes and vehicles is performed in the same manner as in Connecticut.

Pennsylvania

The Pennsylvania Department of Revenue has 25 special investigators assigned exclusively to cigarette contraband enforcement. These agents are armed, have authority to make arrests, and have access to state vehicles. The Department makes use of a "hot line" for receiving tips on illegal shipments and pays informers 50c per carton for contraband cigarettes which are seized as a result of information they supply.

Any person who sells a pack of cigarettes which does not bear the proper state tax stamp shall, upon conviction in a summary proceeding, pay the court costs and further be subject to a fine of not less than $100 nor more than $1,000 and/or imprisonment for a term of not more than 60 days. Any person who falsely, fraudulently, maliciously, intentionally, or willfully sells any pack of cigarettes not bearing the state tax stamp shall be guilty of a felony and, upon conviction, shall be subject to a fine of not more than $15,000, court costs, and/or a maximum term of five years. Possession of more than 200 but less than 1,000 untaxed cigarettes constitutes a summary offense and, upon conviction, the defendant shall pay a fine of $300 plus costs of court and/or be confined for not more than 90 days. Possession of 1,000 or more untaxed cigarettes subjects those convicted to a fine of not less than $1,000 nor more than $15,000, court costs, and/or imprisonment for not more than three years. Any person who falsely or fraudulently, maliciously, intentionally or willfully with intent to evade the payment of the Pennsylvania cigarette tax possesses any pack of cigarettes which does not bear the state tax stamp shall be guilty of a felony and, upon conviction, be subject to a fine of not more than $5,000, court costs, and/or imprisonment of not more than five years. Conviction for counterfeiting, or possession of any device designed to counterfeit tax stamps, is a felony and carries a fine of not more than $10,000, court costs and/or imprisonment for not more than ten years. The state statutes also provide for the confiscation of contraband cigarettes and vehicles in which more than eight cartons of untaxed cigarettes are found.

Rhode Island

Rhode Island has one full-time investigator who is assigned to cigarette tax enforcement. At present the Department of Revenue is also using two CETA employees to make checks of stamps at retail outlets. The state does not provide vehicles, makes no use of telephone "hot lines", nor does it provide for payment of informers.

Any person who sells unstamped cigarettes is liable to a fine of not less than $150 and not more than $500 for the first offense. For each subsequent offense the fine is not less than $200 plus $25 for each carton in excess of eight cartons but not to exceed $10,000 and/or imprisonment for not more than three years. Any person other than a licensed distributor or licensed dealer who knowingly purchases any cigarettes not bearing the required indicia is liable for a fine of not more than $100 for each offense. Counterfeiting of tax stamps or possession of a device designed for this purpose is a felony and punishable by imprisonment for not more than ten years. Rhode Island's statutes provide for the confiscation and sale of contraband cigarettes but not the vehicles in which they are found.

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