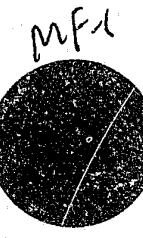


RACKETEERING IN THE SALE AND DISTRIBUTION  
OF CIGARETTES - 1



HEARING  
BEFORE THE  
SUBCOMMITTEE ON  
CRIMINAL LAWS AND PROCEDURES  
OF THE  
COMMITTEE ON THE JUDICIARY  
UNITED STATES SENATE  
NINETY-FIFTH CONGRESS  
FIRST SESSION  
ON  
S. 1487  
OCTOBER 21, 1977

Printed for the use of the Committee on the Judiciary



U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON : 1978

83611-  
83612

U.S. Department of Justice  
National Institute of Justice

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(III)

HEARING ON S. 1487—TO ELIMINATE RACKETEERING  
IN THE SALE AND DISTRIBUTION OF CIGARETTES

FRIDAY, OCTOBER 21, 1977

U.S. SENATE,  
SUBCOMMITTEE ON CRIMINAL LAWS AND PROCEDURES  
OF THE COMMITTEE ON THE JUDICIARY,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10:35 a.m., in room 2228, Dirksen Senate Office Building, Senator Edward M. Kennedy (acting chairman) presiding.

Staff present: Paul C. Summitt, chief counsel; Russell M. Coombs, deputy chief counsel; Robert M. McNamara Jr., assistant counsel; and Mabel A. Downey, chief clerk.

Senator KENNEDY (acting chairman). The subcommittee will come to order.

Today the Subcommittee on Criminal Laws and Procedures begins hearings into an area of criminal activity which, in the past decade, has grown to alarming proportions. This activity is subtle in nature, sometimes violent and brutal in its methods, and certainly devastating in its results. I am speaking, of course, of the serious problem of cigarette bootlegging.

The cause of the problem is amazingly simple: Over the past 10 to 12 years the increasing disparity of cigarette tax rates of various States has made it very profitable to transport large quantities of cigarettes from low-tax States to high-tax States, where they are then sold at prevailing rates. By avoiding the taxes in high-tax States, illegal profits of \$1.50 to \$2.50 per carton can be realized. When this figure is translated into large quantities, a bootlegger can realize a profit of \$93,000 to \$180,000 per tractor trailer load.

It is important to understand at this juncture that our immediate concern is not with the person who purchases two or three cartons for himself in a low-tax State. While this type of casual smuggling is certainly illegal under State law since it deprives the State of needed tax revenue, such bootlegging is a small part of a much greater problem.

The problem with which we are immediately and seriously concerned is the organized smuggling of large quantities of bootlegged cigarettes by major crime groups. What we are witnessing is a classic example of organized crime abhorring a profitable vacuum. Recent studies and intelligence reports have clearly documented the fact that organized crime now controls a lion's share of this illegal activity.

The end result of this activity is frightening not only in its scope but also in its potential for even more widespread growth. Not only

have States lost literally hundreds of millions of dollars of needed State tax revenue which has ultimately found its way into the coffers of organized crime, but also thousands of legitimate wholesalers, retailers, drivers, packers, and salesmen have lost their livelihood and businesses as a direct result of organized crime's takeover. With the infiltration of organized crime into this area, there has been evidence of increasing, violent crime: Extortion and bribery, truck hijackings, armed robberies, serious assaults, and even murder.

In 1972, when Congress first addressed the problem of cigarette bootlegging, the consensus apparently was that the problem was one for the States to deal with and that their efforts up to that point had been inadequate. In the past 5 years the complexion of this same problem has changed dramatically. Because of the infiltration and takeover by organized crime, the problem is no longer isolated to individual States but rather is a major Federal concern. In spite of the efforts many States have made over the years, it is clear that these efforts are hopelessly inadequate to deal with the highly sophisticated and frequently ruthless methods employed on an interstate level. The time is certainly ripe, if not long overdue, for Congress to take a fresh look at the problem of cigarette smuggling and determine the nature and extent of the Federal response.

We are pleased to have with us today a number of witnesses whose efforts, research and experience will hopefully give us a better understanding and appreciation of the scope of the problem as well as assistance in arriving at a possible solution.

We are delighted to welcome our colleague and good friend, the Senator from Florida, Senator Chiles, who has long been interested in this problem. His State is one of the States that has been most directly affected. We are interested in hearing his views about this problem and ways that we can best deal with the issues.

Senator Chiles?

#### STATEMENT OF SENATOR LAWTON CHILES, A SENATOR FROM THE STATE OF FLORIDA

Senator CHILES. Mr. Chairman, I want to congratulate you on holding these hearings and the work that you are doing in trying to combat organized crime. I certainly want to add my voice to support this legislation. This bill would give law enforcement officials a new tool to fight organized crime and its operatives who have found still another way to rob State and local governments of needed tax dollars.

My State of Florida has a big stake in this fight.

A package of cigarettes in Florida carries a State tax of 21 cents. Add 2 more cents per pack for the State's sales tax and a pack of cigarettes costs almost as much in Florida as it does in New York City.

In fact, New York City is No. 1 and Florida is No. 2 in the cost of cigarettes.

Take the State's high cigarette tax, add the number of interstate highways entering Florida and the State's close proximity to those tobacco-producing States which levy almost no cigarette tax and you've got the perfect market for cigarette smugglers.

One man took advantage of the situation earlier this year when he outfitted his camper-van with hollow walls, and false floors and drove to North Carolina.

Florida officials were tipped off on his return to the State and while the van's interior looked perfectly normal, a close examination revealed about 6,000 cartons of cigarettes.

This smuggler probably paid about \$3.25 for each carton. He would have sold them for \$4.50 to \$4.75 per carton, making a quick profit of \$7,500 on a quick trip in his camper trailer. People that are just in an automobile could make \$2,500. You have cited what happens when we go up from the automobile to the van, to the four-wheeler. They are coming in in that way, too.

Cigarette smuggling is not new to Florida. Indeed, State revenue officials estimate Florida lost \$35 million last year in uncollected cigarette tax revenue.

Cigarette smuggling is so incredibly easy that officials tell story after story of people stuffing their car with 2,000 cartons and turning profits of \$2,500, as they resell the cigarettes to friends and co-workers. Not a small profit for a weekend's work.

Smugglers in Florida have also used the U.S. Postal Service. In a case now before a Federal grand jury in Tampa, a North Carolina man is charged with offering a regular mail order subscription service to residents of the Tampa Bay area.

Officials estimate the North Carolina businessman grossed more than \$700,000 in the 7-to-9 month period he was under surveillance.

The grand jury looks to return indictments under the catchall Federal mail fraud charge to stop mail-order operations.

Cigarette smuggling, according to a series on the subject by a St. Petersburg television station last month, is so widespread that a shop in downtown Tampa was selling contraband cigarettes in plain view in two vending machines located right inside his front door.

But while those cigarettes were easily spotted by agents making a routine inspection of vending machines, untold hundreds of thousands of other packs of cigarettes sport a forged cigarette tax stamp.

The stamps are so good that the untrained eye cannot detect the fraud.

In a warehouse raid in Broward County last year, just under a half-million packs of cigarettes were seized, many with counterfeit revenue stamps.

Police said a burglary had been staged at the same warehouse a year earlier and a cigarette stamp machine had been reported stolen.

The subsequent raid turned up the old machine, doctored so its stamps could not be traced. The distributors were putting fraudulent stamps on cigarettes and selling them to unsuspecting retailers.

The cigarette distributor was convicted of counterfeiting cigarette tax revenue stamps.

Cigarette bootlegging is not the victimless crime some would like to believe and witnesses who follow me will tell of the profits reaped by those in organized crime who have entered the business of smuggling cigarettes.

Florida, like many other States, returns a portion of the money collected through the cigarette tax to the municipality or county in which the cigarettes were purchased.

In Florida's case, it is 70 percent which goes back to the local government. Many of our State's smaller municipalities operate on and provide services solely on the revenue generated by the tobacco tax.



Many others operate various government departments, such as their police departments, on the revenues.

The Florida Legislature recently budgeted for eight new inspectors in the State's beverage department to do nothing but fight cigarette smuggling. But their efforts will mean little if we do not get a penalty to back them up.

I am not usually an advocate for an increased Federal role, but I do not believe we can continue to sit back and allow organized crime to continue to rob our State and local treasuries because it can operate across the same State boundaries which stop State and local law enforcement officials.

Section 1289 of the bill explicitly acknowledges the concurrent jurisdiction of State law enforcement officials in fighting cigarette bootlegging. This is a balanced approach that strikes me as the kind of partnership arrangement that will be welcomed by State and local law enforcement officials.

While we are examining the bill I think we should look at raising the maximum sentences and fines. A maximum fine of \$10,000 and a maximum jail sentence of 2 years may not be enough. With the profits involved in bootlegging, some might view these penalties as merely the cost of doing business, especially if they could have some fall guy to take the penalty.

One other section of the bill might be examined with an eye toward making it tougher for bootleggers.

The legislation under consideration defines contraband cigarettes as a quantity in excess of 20,000 individual cigarettes. That's 1,000 packs or 100 cartons and perhaps consideration should be given to lowering that figure to 50 cartons. I know we're not trying to catch the person that is going to another State and brings back several cartons of cigarettes. But it seems to me that if you are taking back 100 cartons or even 50 cartons you are certainly in the business of trying to smuggle and reap a profit.

Since it would take a three-pack-a-day smoker almost a full year to smoke 100 cartons of cigarettes it is evident that anyone who has 100 cartons in their possession is in the cigarette selling business.

I commend you, Mr. Chairman, for your interest in focusing attention on this issue. I hope this bill can become law well before the end of the 95th Congress and I want you to know that I will help in any way I can toward that end.

I know that you are familiar with this but I think the pamphlet that was done by the Advisory Commission on Intergovernmental Relations, *Cigarette Bootlegging: A State and Federal Responsibility*, was most helpful to me and I am sure that will be a part of your record.

Senator KENNEDY. It will be made a part of the record and inserted after the testimony of the representatives of the Advisory Commission on Intergovernmental Relations. [See p. 16.]

I want to thank you, Senator Chiles, for your excellent statement.

In the ACIR report which you referred to, there are charts which show the States which have been the large revenue losers. Florida is one of them. As I understand it, the cigarette traffic moves in corridors through several States. It funnels down to Florida and comes up to the Northeast and to Massachusetts and even up north of us into Maine.

We will hear later on in the day about how these corridors are structured and how they are set up. I would think that it would be exceedingly difficult for well-intentioned law enforcement officials, even in Florida, to be able to track this as it goes into other States because of the way the State laws are established at the present time. Isn't that what we are talking about—the fact that cigarette smuggling is well organized and that it can be demonstrated quite clearly the corridors exist in the East and up to the Northeast and down into the Southeastern part of our country? The ability of the States to deal with this is extremely limited, as I understand it.

Senator CHILES. It certainly is. We had many instances but there is one specific case in south Florida where a raid was made and cigarettes were found in large quantities. Also found there was definite evidence at that time showing where the cigarettes were coming from and how they were being stored in other places prior to coming there. These came from tobacco-producing States.

We do not get very good cooperation from some of the tobacco-producing States and there was no way the local Florida officials could go into what was a conspiracy, and to try to trace this contraband that was coming into the warehouses and from the States it was being organized in and coming out. If it was a Federal crime, which of course it should be, then the Alcohol and Tobacco control people could come in and on the basis of a conspiracy they could bring charges. They could also hit those locations and stop some of the staging points. That would be tremendously helpful in trying to break this up.

Senator KENNEDY. The proposed legislation which we are considering is rather limited. It would require that certain recordkeeping procedures be observed and various records maintained. There is a legitimate question, which I have heard you speak eloquently about, which is the additional burden that would be placed upon retailers and outlets in terms of such recordkeeping requirements. However, the provisions of this legislation really only require the kinds of invoices that any responsible outlet would maintain as a normal business practice. These records would be kept and would be available to the law enforcement officials.

Finally, I think you would agree with me that cigarette bootlegging is a major source of revenue for organized crime. It is my understanding that organized smuggling is one of the major sources of revenue for organized crime. I don't believe most people understand that.

Senator CHILES. I think you are absolutely right.

Senator KENNEDY. We are talking about hundreds of millions of dollars of lost tax revenue being diverted into the coffers of organized crime. We are talking about tens of millions of dollars over a period of a few years, and hundreds of millions of dollars of lost revenue. We are trying to reach both of these issues—lost State tax revenues and organized crime activity.

Senator CHILES. That is exactly correct. So not only am I talking about a \$35 million a year that is coming out of the local governments' pockets. This is revenue that they are not receiving.

Senator KENNEDY. They have to make it up some way.

Senator CHILES. Yes; that means higher property taxes. That is the only other source of revenue of local government, so that is higher real property taxes on people.

But not only that, as we are funneling that money into organized crime, which in many instances is coming back to compete by being put into restaurants and other legitimate operations which are fronted by the organized crime people, so it is coming back in to compete with the businessman. That is about the most unfair thing that you could have.

To show the extent of our inability to deal with this, the Florida Legislature recently raised the tax on cigarettes. The legislature does that once in awhile when they are looking for revenue. They were criticized by a number of the newspapers and a number of people in Florida. By raising revenue all they were going to do was add to the bootlegging traffic and by virtue of the fact that Florida that has such a high tax now, then we would just be raising the bootleg traffic. That State action is simply going to cause a reduction, perhaps, in the legitimate sales and an increase in the illegitimate sales because there is no way that the State officials can really police this unless we can recognize that it is an interstate crime and they would have to bring Federal authorities into it.

Senator KENNEDY. I think you are absolutely right. We will hear during the course of the morning the difficulties that the States have had in trying to deal with this serious problem. Cigarette bootlegging has increased dramatically over the past 3 or 4 years. I think it will even grow larger unless we are prepared to deal with it. One method of dealing with the problem is the legislation we have proposed.

So, we have a legislative remedy.

We will ask you to join with us to do some things administratively within the Justice Department and the interagency task force which could begin to coordinate this action at the present time in administrative ways.

Senator CHILES. I look forward to working with this. My subcommittee has the budget of the Alcohol and Tobacco people. As soon as we have a basis for bringing them in, I want to see that they have the adequate resources and the direction that they are going to move in this area.

Senator KENNEDY. Thank you very much.

We want to first of all mention that Senator Bellmon, who introduced this bill, planned to be with us. He is the prime sponsor of the bill. We will include his statement in its entirety in the record. Senator Anderson, who also is a cosponsor, intended to be here.

STATEMENT BY SENATOR HENRY BELLMON, SENATE JUDICIARY SUBCOMMITTEE ON CRIMINAL LAWS AND PROCEDURES

Re S. 1487, Federal Cigarette Contraband Bill.

Mr. Chairman: Let me begin by expressing my appreciation to you and the subcommittee for the timely manner in which you have scheduled these hearings. The rapid growth of cigarette bootlegging throughout the country gives rise to the need for today's hearing and to passage of this legislation. I feel certain the testimony you are to receive will be most beneficial in your consideration of S. 1487.

As you know, Mr. Chairman, S. 1487 would sharply expand the Federal role in the fight against cigarette bootlegging which has become a major source of income to organized crime. The tax rate differential between Tobacco producing states and Tobacco consuming states makes cigarette bootlegging a highly profitable illegal enterprise. It is so profitable Mr. Chairman, that a great number of states are being deprived of much-needed revenue which would otherwise be

collected through the various cigarette tax laws applicable to each state. This high profit, coupled with varying state revenue and enforcement laws throughout the United States, provides the inducement to organized crime to engage in the sale of contraband cigarettes. It has been estimated that the sale of contraband cigarettes nationwide costs state governments \$330 million a year in lost tax revenue.

Mr. Chairman, if there is to be an effective law enforcement effort against cigarette bootlegging, the role of the Federal government must be expanded, particularly in view of the interstate nature of the crime. S. 1487 is addressed to that need. I am convinced that when enacted, this bill will provide a timely solution to this element of our nation's serious organized crime problem as well as providing needed income to many cities and states. For this reason, the Federal Contraband Cigarette Bill must be given serious and positive consideration by this Congress.

Once again Mr. Chairman, let me commend you on your interest in this legislation as exhibited by this hearing today. Like yourself, I am anxious to learn of the opinions and suggestions that will be offered by the witnesses today so that all concerned will have a greater understanding of the problem faced, and the solutions which will help alleviate this particular crime.

Thank you.

Senator KENNEDY. We will ask Wayne Anderson, who is the Executive Director of the Advisory Commission on Intergovernmental Relations to come forward. He is accompanied by F. John Shannon and Robert Kleine.

I was chairman of the Subcommittee on Administrative Practice and Procedure of the Judiciary Committee for a number of years, and one of the things that we looked at were reports that were being done by Government agencies that had disappeared and gathered dust in the pigeonholes. I am so glad to see that we have one here which is hopefully going to be the basis for constructive action and which we can rely on for its thoroughness. It will be very valuable to us.

We welcome you this morning.

STATEMENT OF WAYNE F. ANDERSON, EXECUTIVE DIRECTOR,  
ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS,  
ACCOMPANIED BY ROBERT KLEINE

Mr. ANDERSON. Thank you very much.

I am Wayne Anderson, Executive Director of the Advisory Commission on Intergovernmental Relations. I am not accompanied by John Shannon but by Robert Kleine, the principal author of the report.

We appreciate the opportunity to appear in support of Senate bill 1487 which we are confident would reduce racketeering in the sale and distribution of cigarettes and also the opportunity to summarize our Commission's report.

Our study was designed to answer three questions:

What is the extent and nature of cigarette tax evasion in general and cigarette bootlegging by organized crime in particular?

Is it reasonable to conclude that the states can handle the organized crime problem without additional Federal help?

If the answer is no, then what should be the appropriate Federal action?

As to the extent of the problem, the major findings of our study are as follows:

Tax evasion activities, which cost the high-tax States and localities almost \$400 million in 1975, are primarily due to State tax differentials

and are a serious problem in 14 States and a moderate problem in another 8 States.

There are four distinct types of cigarette smuggling or tax evasion activities that account for this revenue loss:

Casual cigarette smuggling—in its most common form, a resident of a high-tax State who lives near the border of or is on vacation in a low-tax State will buy cigarettes for personal use or for friends.

Organized cigarette smuggling—this activity involves the transportation of cigarettes between States for profit and can range from a small, part-time operation to a large-scale business run by organized crime figures.

Mail order purchases of cigarettes—this type of smuggling involves the transportation of cigarettes through the mails from low-tax States to high-tax States for the purpose of avoiding the tax.

The purchase of cigarettes through tax free outlets—untaxed cigarettes can be obtained from three primary sources—international points of entry, military post exchanges, and Indian reservations.

While it is difficult to determine the relative importance of these factors in each State, there is sufficient evidence to conclude that the cigarette tax loss in the States of the Northeast corridor can be attributed either predominantly or heavily to the network of organized crime.

In sharp contrast, several of the southern and western States characterized as major revenue losers—Alabama, Texas, and the State of Washington—trace their problems to abuses in the purchase of cigarettes from military post exchanges and Indian reservations and to casual cigarette smuggling.

Contrary to popular belief, cigarette bootlegging is not a minor, victimless crime in many States. Cigarette smuggling is a major source of revenue for organized crime groups.

The States have devoted some effort to curtailing cigarette smuggling, but these efforts have not been very effective because of the interstate aspect of the problem and the lack of adequate resources.

Senator KENNEDY. Can you give us a breakdown of the various categories of smuggling as to what is casual and what is not?

Mr. ANDERSON. There is not a method available to determine what part of the \$400 million revenue loss would be attributed, for example, to organized crime, to mail order purchases, and so forth. We have informed opinions that the organized crime portion may well be in the \$150 million to \$200 million area. We know the total losses to the states from military bases is about \$130 million but, of course, we cannot isolate how much of that is related to smuggling. So the breakdown is not determinable.

Regarding the Commission's study methodology—in estimating State revenue gains and losses resulting from cigarette tax evasion, the Commission staff used regression analysis. The analysis isolated the effect of cigarette tax rates on per capita cigarette sales and enabled us to estimate revenue losses due to cigarette tax evasion tactics in each individual state. The staff's analysis revealed that approximately 40 percent of the revenue loss on cigarette sales was due to reduced consumption associated with a high tax rate, while the remaining 60 percent represents that portion of the total tax impact attributable to cigarette tax evasion.

A full explanation of the study methodology is appended to this statement.

Cigarette tax evasion, whether it is by organized racketeering or casual smuggling, has four undesirable consequences. The most obvious consequence and the one most publicized is the lost in State cigarette tax revenue. This loss affects some States minimally but others significantly. Where the loss amounts to millions of dollars it is also likely to be significant in terms of public services. States that suffer a major financial loss from cigarette tax evasion have a Hobson's choice. They either reduce services commensurate with revenue loss or increase other taxes to make up for the cigarette tax shortfall.

Cigarette tax evasion has equally baneful effects on business and particularly the tobacco industry. The Commission heard testimony to the effect that cigarette manufacturers have lost trucks to hijackers and that cigarette wholesalers and retailers are losing business as racketeering diverts cigarettes from normal trade channels.

One witness told the Commission that in New York City 50 percent of the employees of wholesalers and vendors have been thrown out of work and that retail candy stores and office building news stands are being put out of business—presumably because an estimated one of every two packs of cigarettes consumed by smokers in the city is bootlegged.

A special task force studying the New York State problem pointed out that:

The State has discovered that these untaxed cigarettes are being increasingly sold in legitimate retail outlets. In other words, more and more businessmen and women, who are law abiding in other respects, have become law violators by evading the cigarette tax. Moreover, they are assisting in robbing the State of much needed revenue at the same time that they are becoming accomplices of big-time racketeers and small-time hoodlums. Perhaps most tragic, the legitimate retailers who have become tax evaders by selling contraband are subjecting themselves to arrest and criminal prosecution with resultant disgrace to their families as well as themselves.

The conversion of legitimate retailers into tax evaders and criminals makes the point that cigarette tax evasion is not a victimless crime—the fourth aspect of the cigarette tax evasion problem. Edward Lorch, a detective in the intelligence division of the New York City Police Department, told the Commission about several murders that resulted from competition among organized criminal elements for turf in which to distribute their bootlegged cigarettes. Detective Lorch went on to note that there have been other instances of violence against persons simply trying to make a living in the legitimate cigarette business. He stated that many dealerships in the New York area are secured like fortresses and trucks making deliveries are more like armored cars than delivery vans.

Two factors can be cited as prime causes of the cigarette tax loss problem:

1. Tax rate differentials—(a) high rates in the Northeastern States caused by their fiscal plight; (b) low rates in tobacco growing States, a self-interest situation.

2. The 1964 Surgeon General's report.

There is little disagreement that interstate bootlegging is caused by the wide difference in the price of cigarettes brought about by the wide difference in tax rates in various states. The cigarette tax rate ranges

from 2 cents per pack in North Carolina to 21 cents per pack in Connecticut and Massachusetts. This variation makes it very profitable to purchase cigarettes in a low-tax State such as North Carolina and sell them illegally in Connecticut and Massachusetts. Because it is generally agreed that it becomes profitable to bootleg cigarettes when the price differential is 10 cents per pack, a \$1.90 difference per carton of cigarettes provides a substantial profit opportunity for those willing to engage in the illegal transportation of cigarettes.

Cigarette bootlegging did not become a serious problem for state and local governments until the late sixties. Prior to that time, the price and tax differentials were not wide enough to encourage such activities. In 1960, the largest difference in cigarette taxes between any two States was 8 cents and the widest variation in the retail price of cigarettes was about 10 cents. The price differential between North Carolina and New York was only 5.2 cents per pack.

In 1976, the retail price of cigarettes, including taxes, varied from 57.6 cents per pack in Connecticut to 35.8 cents per pack in North Carolina—a 21.8 cent difference. The price differential between New York and North Carolina was 18.4 cents.

The large differentials in cigarette taxes are mainly among the low-tax, tobacco-producing States and the high-tax Northeastern States. There is pretty much a high-tax belt from Pennsylvania on up through Massachusetts. The tax rates in 39 States fall between 8 and 17.75 cents. It is the States at the extremes, however, that create the serious bootlegging problem.

Cigarette bootlegging has caused a significant shift in per capita cigarette sales among the States. In 1955, cigarette sales in the Northeastern States were well above the national average, while sales in the Southern States were consistently far below the national average. This large divergence was due largely to economic and cultural factors because there was little evidence of cigarette smuggling in 1955. By 1965, the cigarette sales pattern had begun to change in favor of the Southern States, although sales were still significantly higher in the Northeastern States. Ten years later, widespread cigarette smuggling had reduced cigarette sales in the Northeastern States to well below the national average, while sales in several Southern States had risen substantially above the national average.

In sum, the cigarette tax differentials among the States established the environment for tax evasion and bootlegging. A healthy market for contraband cigarettes now exists. A strong incentive for cigarette bootlegging is created by the profit potential and the procedures for cigarette transportation and sale are in place. This activity can only grow if a forthright enforcement program is not established.

There is no question but that the 1964 Surgeon General's report stands out as a primary factor in causing growing disparity in State cigarette tax rates. State legislators, particularly in the hard pressed Northeast region, justified their decision to sharply increase cigarette tax rates on the grounds that it would both provide urgently needed revenue for the State and would also reinforce Federal policy—that of discouraging the personal consumption of a product that is dangerous to health.

We come then to the question of what is the desirable intergovernmental action.

In speaking first about the role of the States, we ask: Is it reasonable to conclude that the States will be able to eliminate cigarette smuggling by organized crime without Federal assistance?

The Commission believes this is not a reasonable conclusion. Two considerations underpin this judgment:

First, the prospects for significant equalization of State tax rates are very poor. The tobacco-producing States, which have low cigarette taxes, are in relatively good fiscal condition. They can be expected to resist any attempt to raise their cigarette taxes significantly. Even when they were not in such good fiscal condition, the significance of the tobacco industry in these States prevented the increase of their cigarette taxes.

In contrast, the high-tax States can be expected to resist with equal vigor all efforts to reduce their cigarette tax rates because of their critical or near critical financial status. Beyond this element of fiscal pressure, the stance of the high cigarette tax States can be traced also to their firm belief that the cigarette bootlegging problem is a Federal as well as State level responsibility. In support of this attitude, officials in these States point to organized criminal involvement, the interstate nature of the problem and the impact of the 1964 Surgeon General's report upon their cigarette tax policy.

Second, without Federal assistance States will be severely hobbled in their efforts to contain the growth in cigarette racketeering. Testimony given before our Commission clearly highlighted this problem. Enforcement officials from northeastern States, for example, have frequently trailed vehicles loaded with contraband cigarettes through North Carolina and Virginia, only to be given the slip by the time they reach Pennsylvania, New Jersey, or New York—jurisdiction in which they had the authority to make the arrest.

Senator KENNEDY. Are the States able to coordinate their law enforcement efforts? What has been the record here?

Mr. ANDERSON. I will call on Mr. Kleine. There have been several very noteworthy coalitions working in the field as well as some very impressive efforts by single States. But as to the coalitions, I will ask Mr. Kleine to speak.

Mr. KLEINE. There is a coalition in the Midwest that is being financed by an LEAA grant. I think there are about seven Midwestern States that are cooperating to try to do that in the Midwest.

There is also an informal—

Senator KENNEDY. How successful is it?

Mr. KLEINE. They have not been that successful. They have made some impact but not to a great degree.

There is also an informal coalition of Eastern States, I believe seven or eight Eastern States that are also dealing with cigarette bootlegging. They have had some success but by no means have been able to deal effectively with the problem.

Senator KENNEDY. Why is that?

Mr. KLEINE. I think basically it is because of the interstate nature of the problem. It is very difficult for the States to locate the bootleggers. They are somewhat underfunded. They have limited resources. The eastern group has people on loan from all the different States and they have requested Federal funding but not received it. The nature of



cigarette bootlegging makes it easy to smuggle them. It is very difficult for the States to deal with them in terms of the resources they have. The law is also quite weak in most of the States. Some of the States like New York have quite stringent laws but normally States have weak laws.

Even if they catch bootleggers they receive minor penalties and they go back into it in a very short time.

Mr. ANDERSON. Perhaps one of the best ways to indicate the weakness of the present law enforcement setup is to indicate what a Federal law would do to change it.

At the moment if a truck now leaves North Carolina and is being trailed by New York policemen, they do not have the basis of jurisdiction for an arrest until it reaches New York. Whereas with the Federal contraband law, the arrest could be made as soon as the truck crossed the Virginia border. The arrest could be made by a cooperating Federal law enforcement official.

The other thing is that a Federal law would make penalties stiffer.

Senator KENNEDY. Why would that make it so much better? Does it make much difference in terms of apprehending smugglers or dealing with the problem? Why does it make such a difference?

Mr. ANDERSON. As I remember the testimony from Detective Lorch of the New York City Department, I believe that he said that 9 out of 10 trucks give them the slip between North Carolina and New York City.

Senator KENNEDY. You mean they can't trail the trucks?

Mr. ANDERSON. They often do trail them but often are given the slip. Of course, the truck drivers probably are expert in trying to achieve that objective.

Whereas, presumably they would get a 50-percent success ratio or much greater than they now enjoy if such a truck could be apprehended going across the first State line.

Second, the State penalties are uneven. In many cases they are not high enough. We call upon them to make them stiffer.

Senator KENNEDY. What is the range of State penalties? Could you provide that for the record?

Mr. ANDERSON. We have a full table in our report, Mr. Chairman. It shows what they are.

Mr. KLEINE. In some States they can be as low as \$100 fine and usually they do not get jail sentences. There may be a provision for 90 days in jail in some of those States.

New York, I think, can go—and Michigan and some of the other States—can go up to 2 to 5 years in prison and stiff fines of \$1,000 or more.

On very rare occasions would someone receive such a penalty. In a recent case in New York State that you might hear about later, we had a penalty in that range. That is unusual.

Mr. ANDERSON. This is then, Mr. Chairman, one of the two corrective approaches that our Commission considered involving the Federal contraband law that is the subject of the bill before you.

Some persons have suggested the Federal "buy out" approach. In effect, the Congress would raise the present Federal tax rate from 8 cents to say 23 cents per pack. Congress would then distribute this

additional tax revenue back to the States provided they, in turn, either vacated the cigarette tax field or imposed very low rates.

In theory, this "buy out" approach has great appeal. At one fell swoop it would eliminate all four types of cigarette tax evasion—organized crime and casual smuggling, as well as mail and tax-free sales abuses.

In the Commission's judgment, however, to push for the Federal buy out approach at this time would be an exercise in political futility—tantamount to a do-nothing policy. Why? Because most Members of Congress would probably take a dim view of tripling the Federal tax rate on cigarettes in order to provide extraordinary financial assistance to a few high-tax-rate States.

This leaves as the only practical option—at this time—the much more limited form of Federal assistance that would be provided by the enactment of S. 1487. Our Commission, therefore, recommended that the Congress "give early and favorable consideration to legislation prohibiting the transportation of contraband cigarettes in interstate commerce."

Admittedly, the passage of the bill will be responsive to only 1 of the 4 forms of tax evasion—the smuggling of cigarettes by organized crime. It is this form of tax evasion, however, that is of greatest concern to the States because unless we can develop more effective enforcement strategies cigarette bootlegging by organized crime will surely become a far more serious problem than it is at the present time. The four major factors conducive to racketeering on a grand scale are now in place:

One, the market is there to be tapped;

Two, high profits provide the financial incentive;

Three, the racketeering process is now established—pick-up areas, drivers, trucks, distribution points; and

Four, the lack of serious risk—cigarette racketeering is not a Federal crime.

The Commission recognizes clearly that the passage of Federal contraband legislation should not give States a license to relax their own cigarette tax enforcement efforts. When the Commission learned that some States lack the statutory basis to conduct a meaningful enforcement program at the present time, it recommended:

That officials in those states affected by cigarette smuggling examine their statutes and, where appropriate, broaden these laws to make a felony any act involving the shipment, sale, and possession of a substantial number of contraband cigarettes and to increase the penalty provisions. The Commission further recommends that state and local officials consider the transfer of criminal penalty provisions from tax law to penal law.

The Commission's recommendations are designed to develop those joint Federal-State cooperative actions that hopefully will result in a significantly reduced level of cigarette tax evasion.

Again, we appreciate the opportunity to testify.

Senator KENNEDY. Mr. Kleine, is there anything you would like to add?

Mr. KLEINE. No, Mr. Chairman, I think it has been covered.

Senator KENNEDY. What is your impression of the organized crime infiltration in this activity?

Mr. ANDERSON. Our study, of course, included no criminal investigative activity. But we had a wealth of evidence on the organized crime

involvement from the official law enforcement agencies, some of whom I know are testifying this morning, principally officials from New York State.

Also Newsday, a Long Island publication, had undertaken a 4-month investigation into cigarette smuggling and principally the organized crime component.

And we had reports from some official agencies.

I suppose the most important facts are that all of the Mafia families in New York State are said to be involved. We had statements to the effect that half the legitimate industry has been crowded and pushed out. We had statements to the effect that virtually every major apartment building and industrial plant in the New York area is a part of the retail network. We had graphic pictorial and other kinds of evidence of the murders involved. It goes on and on.

Senator KENNEDY. Do you feel that the two different approaches of equalizing the taxes and then having a Federal law enforcement approach would be the way to deal with the problem, or are there other ways?

Mr. ANDERSON. Either would have to be supplemented, in our view, and we call for a stronger State enforcement effort. But these are essentially the only two methods that we could place before the committee. It is important to recognize that only the buy out approach could be the 100-percent solution and improved enforcement might be a 30-percent solution. Our Commission was not willing to settle for a 30-percent solution permanently and so it calls for and recommends the contraband law approach and improved enforcement initially. But if improved enforcement has not achieved substantial results within 4 years, the Commission indicated that it would want to go back to the drawingboard.

Senator KENNEDY. What impression do you form as to what the States would do if we pass this legislation? Will they gradually phase out their activities?

Mr. ANDERSON. We do not believe so. We believe your question is a legitimate Federal concern. But the States build-up of enforcement activities in recent years and their self-interest, their development of coalition approaches, and the fact that their activities ought to be a good deal more effective with Federal cooperation causes us to believe that they will continue to improve and certainly not sit on their hands.

Senator KENNEDY. What kind of additional burden do you think this places in terms of the legitimate outlets for cigarettes? We're dealing in an atmosphere and climate in the Congress where it is reluctant to add more regulation and more paperwork, particularly on small outlets and on small businesses.

From your own analysis, what kind of burden is this going to place on legitimate businesses?

Mr. ANDERSON. Mr. Kleine may see some other aspects that I do not see. The testimony that we had in the main with reference to legitimate outlets is that they at the moment, particularly in certain areas of the country, are under great pressure from the illegal elements. I have every reason to fear that they must incur a good deal of expense to protect their operations, their trucks and employees.

Any improvement in enforcement would seem to lessen that and lessen their burdens.

I don't think of any respect in which it increases their clerical or administrative burdens.

Mr. KLEINE. I would point out that the National Association of Tobacco Dealers does support this type of legislation. I think they feel that it would be very helpful to them. They are concerned about the losses of sales because of bootlegging. I do not feel that they think it would create an administrative burden.

Senator KENNEDY. We have heard comment about the 20,000 cigarette limit cutoff. Is that a fair figure? Should it be higher or lower?

Mr. ANDERSON. We talked about that within the staff yesterday, as we have many times in the past. I think, like every line that is drawn, it is subjective. I cannot defend the 20,000 figure any better than I can a 10,000 figure or 25,000 figure. But one of the principles involved is trying to determine an amount of revenue loss, as you often do in law-making, that is significant enough to make illegal. This revenue loss here equates to a couple of hundred dollars. So it seemed a reasonable line.

Senator KENNEDY. If we pass this legislation, what is your assessment as to the impact it would have both immediately and in the future?

Mr. ANDERSON. I think the consensus judgment from the knowledgeable law enforcement officials to whom we talked might be captured in the 30-percent figure, that is, that 30 percent of the smuggling could be dampened by quite effective Federal-State cooperative law enforcement. It is a significant cut but far from totally satisfying.

Senator KENNEDY. What about its growth potential? Would cigarette bootlegging continue to grow regardless of a Federal-State effort? Does your 30 percent estimate also encompass any possible expansion of this activity?

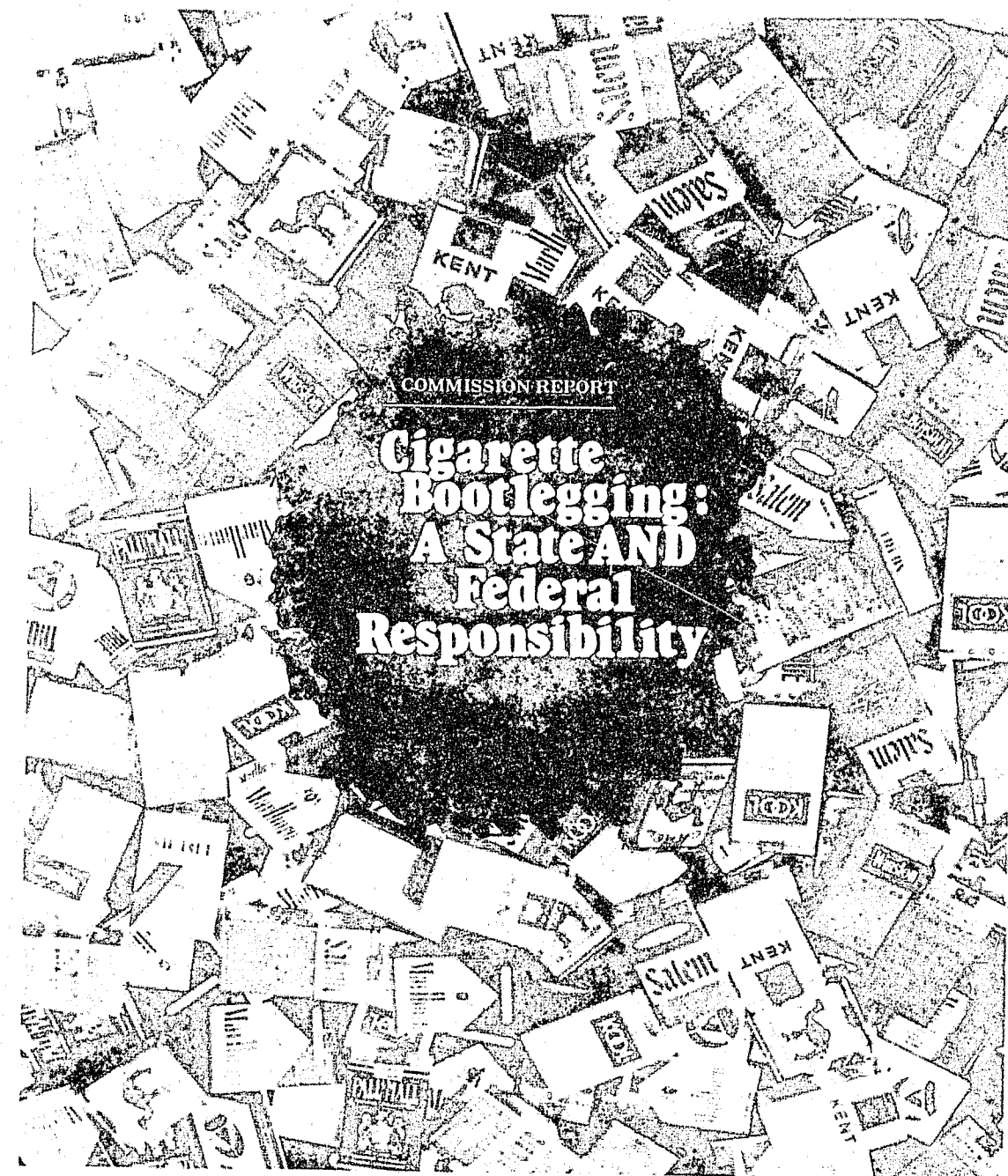
Mr. ANDERSON. Well, it might be 30 percent of the present plus 30 percent of the growth but whether it would slacken the growth somewhat, we have no way of knowing. It might only offset the growth.

Senator KENNEDY. Thank you very much. The ACIR report and other attachments to your testimony will be inserted in the record at this point.

[The material follows:]



Y362



Advisory  
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## Preface

It may come as a surprise to some individuals that a matter as prosaic as State and local cigarette taxes could represent a real test of intergovernmental relations. In this report, the Advisory Commission on Intergovernmental Relations describes the pattern of cigarette bootlegging that has been building for a decade and recommends Federal, State, and local policies to mitigate its effects. The Commission identifies a Federal interest in the field that stems from the link between bootlegging and organized criminal elements. The Commission notes the disparities in State tax policies with respect to cigarette taxation that have given rise to tax differentials that make both casual and organized smuggling of cigarettes a potentially profitable undertaking. The Commission perceives a high degree of citizen indifference to the existence of smuggling—an indifference that results in some citizens paying higher taxes than they might otherwise experience or receiving a lower level of services because States and localities are deprived of essential revenue.

True to its legislative mandate, the Commission in this report is seeking to encourage debate on a public problem that requires intergovernmental cooperation.

**Robert E. Merriam**  
Chairman

## Acknowledgements

This report was researched and written by Robert J. Kleine and Richard J. Reeder under the general supervision of John Shannon, Assistant Director. Will Myers, ACIR Senior Analyst, assisted in preparing the report for publication. Jean Ryan and Lavinia Clarke provided valuable secretarial and clerical assistance.

The Commission and the staff benefited from the help of many individuals and organizations. However, special gratitude is expressed for the cooperation and assistance provided by Leon Rothenberg, Charles Conlon, Morris Weintraub, Melvin Bruce, William O'Flaherty, Edward Lorch, Philip Salafia, J. Robert Murphy, James Lee Taylor, George Stewart, John Deinlein, and James Golden.

These individuals along with those who participated in the Commission hearing in conjunction with this report assured a frank exchange of views on this important intergovernmental issue. The Commission staff, of course, takes full responsibility for the contents and the accuracy of the report.

**Wayne F. Anderson**  
Executive Director

**John Shannon**  
Assistant Director  
Taxation and Finance

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## Findings and Recommendations

Cigarette bootlegging is a tax administration problem that has developed since 1965. Tax evasion, resulting from the transportation of cigarettes from low-tax States for sale in high-tax States, has been described by the Federation of Tax Administrators, "to be among the most troublesome in the entire State tax field."

There are six basic reasons why the States have had difficulty in controlling cigarette bootlegging:

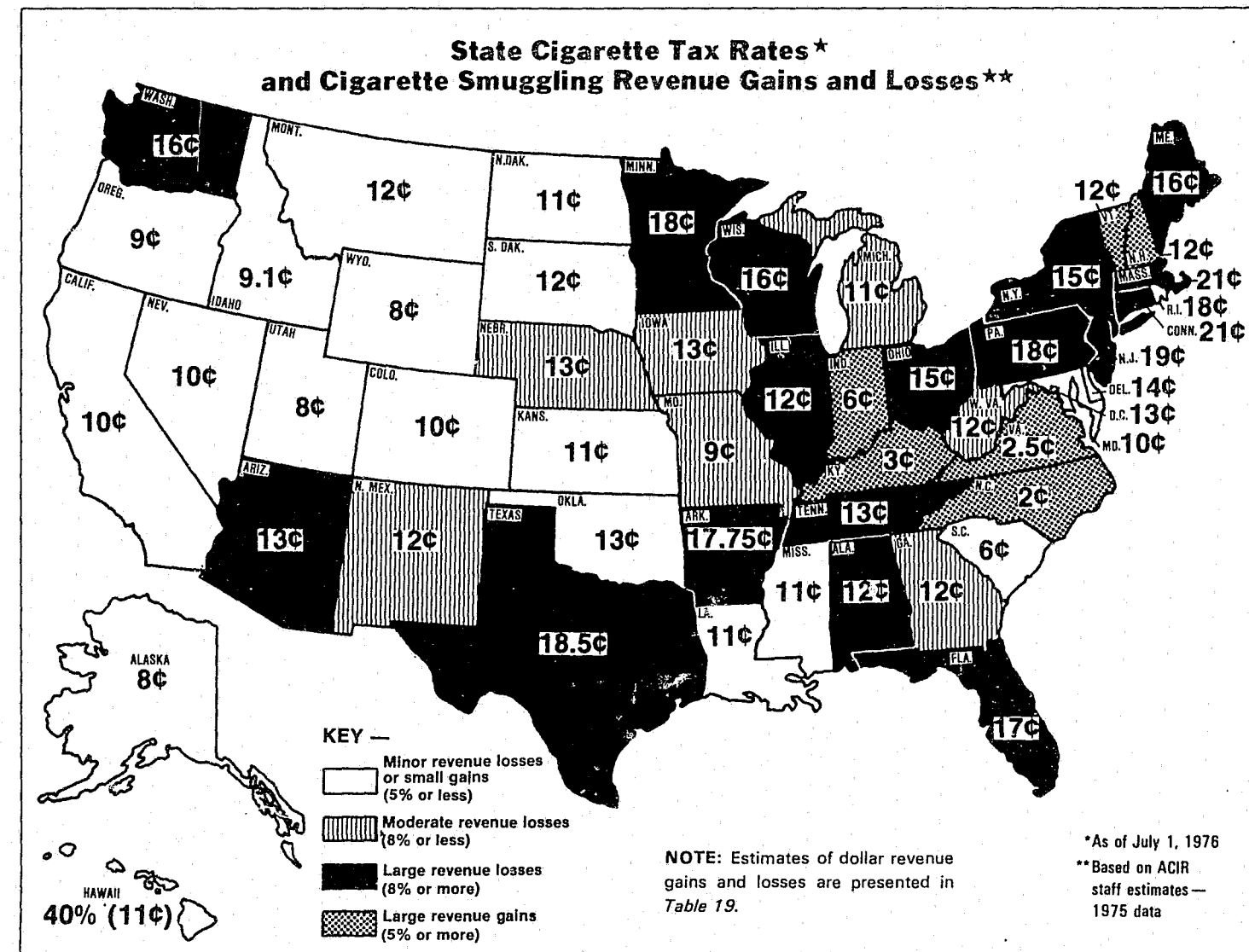
1. Cigarettes are relatively easy to handle and transport and smuggling them across open borders is difficult to detect.
2. Penalties for cigarette bootlegging are generally light and are not an effective deterrent to bootleggers.
3. Cigarette bootlegging is not a Federal offense and the interstate nature of the problem hampers State and local law enforcement efforts.
4. Potential profits in cigarette bootlegging are so great that a wide variety of people are attracted to this illegal activity.
5. Because of the high profit potential, organized crime has become heavily involved in bootlegging.

6. Cigarette smuggling is a law enforcement problem and most tax administrators are not equipped to handle this type of problem.

The basic cause of cigarette smuggling is the disparity in State tax rates. (See Map 1.) Tax rates range from 2 cents in North Carolina to 21 cents in Massachusetts and Connecticut, and 23 cents in New York City. The tax rate disparity between New York City and North Carolina translates to a difference in price of \$2.10 per carton, which provides a highly attractive profit opportunity and invites criminal activity.

In 1965, the range in tax rates was from zero to 11 cents and the profit incentive for smuggling was much less. Today, after a decade of fiscal pressures and the cigarette-smoking health scare, many States have very high cigarette tax rates compared with tobacco-producing States, where rates have been kept relatively low. The resulting tax disparities have spurred bootlegging activity, particularly organized smuggling. Casual smuggling has existed for years, and although of concern to State tax officials, its financial and other consequences pose less of a problem to society than does organized smuggling.

The most visible consequence of cigarette smuggling is the revenue loss to State and local governments in high-tax States—about \$391 mil-



lion each year. This revenue loss is the main reason State tax administrators have become so concerned about the problem in recent years. The consequences of cigarette smuggling, however, extend beyond the loss of government revenues: taxpayers pay higher taxes or receive fewer services, cigarette wholesalers and retailers are driven out of business and jobs are lost, political and law enforcement officials are corrupted, trucks are hijacked and warehouses raided, and people are injured and even killed.

On the surface, the solution to this problem appears simple: reduce or eliminate State tax differentials and bootlegging will disappear. Although true, achieving this solution is far from simple. Many States are relatively unaffected by smuggling and nine States (Indiana, Kentucky, New Hampshire, North Carolina, Oregon, South Carolina, Vermont, Virginia, and Wyoming) receive substantial benefits from cigarette smuggling. Some officials in these low-tax States contend that high-tax States have created the problem by levying unreasonably high cigarette taxes, and they can solve the problem by reducing their tax rates.

Many high-tax States have fiscal problems and are not in a position, fiscally or politically, to reduce cigarette tax rates. The response of these States has been to urge the Federal Government to enact legislation prohibiting the transportation of contraband cigarettes in interstate commerce, a position supported by most States.

A number of cigarette tax experts believe that a uniform tax rate is the only solution. However, there are massive political barriers to the enactment of uniform rates by the States.

In the absence of uniform rates, law enforcement approaches to deal with this problem should be undertaken. A continued lack of strong action could result in a number of serious consequences:

1. Cigarette bootlegging will continue unabated and will increase if tax differentials increase further.
2. State and local government use of the cigarette tax as a revenue raising option will be limited. The reduction in the number of tax increases in the past 2 or 3 years indicates that this outcome may already be happening.

3. Organized crime will continue to reap large profits, which can be used to finance other illegal activities.
4. Tobacco wholesalers and retailers in many States will continue to suffer reduced sales and profits.
5. Taxpayers in States suffering revenue losses due to bootlegging will continue to pay higher taxes (cigarette or others) or receive a lower level of services.
6. Failure of State and Federal officials to take strong action to solve this problem could encourage bootleggers and discourage law enforcement officials.

It must be conceded, however, that some experts question whether increased law enforcement activity on the part of the States or the Federal Government can reduce cigarette smuggling to an acceptable level.

### SUMMARY OF FINDINGS

The major findings of this study follow:

- Tax evasion activities, which cost the high-tax States and localities an estimated \$391 million in revenue losses each year, are primarily due to State tax differentials and are a serious problem in 14 States' and a moderate problem in another eight States.
- Contrary to popular belief, cigarette bootlegging is not a minor, victimless crime in many States. Cigarette smuggling is a major source of revenue for organized crime groups, and this revenue is used to finance other illegal operations.
- The States have devoted some effort to curtailing cigarette smuggling, but these efforts have not been very effective because of the interstate aspect of the problem and the lack of adequate resources.
- The States are not likely to devote the resources needed to adequately control



cigarette bootlegging because of budget considerations, lack of support for strong enforcement of cigarette tax laws in most States, and practical limits on the effort expended to collect a relatively minor State revenue source.

- Cigarette smuggling is largely a law enforcement problem, and State tax administrators cannot effectively deal with this situation—particularly organized crime involvement—without increased reliance on law enforcement personnel.
- The States have cooperated, to some extent, in their efforts to curtail bootlegging, but outside assistance (Federal) is needed to encourage greater cooperation and more coordinated law enforcement efforts.
- Strict enforcement of proposed Federal contraband legislation and heavier State penalties for smuggling could reduce cigarette bootlegging, but the amount of this reduction cannot be predicted with a high degree of accuracy. However, complete elimination of cigarette smuggling clearly will require virtual elimination of State tax differentials.
- The States are unlikely to adopt more uniform tax rates without strong Federal incentives. The high-tax States have pressing revenue needs and, thus, are unlikely to lower their cigarette tax rates, while the tobacco-producing States generally do not have pressing revenue needs and are not favorably disposed to increasing the tax on their major product.
- Cigarette bootlegging has dealt a damaging blow to the legitimate tobacco industry. Many jobs have been lost at the wholesale and retail level. In addition, some dealers have been forced into illegal activities in order to compete with bootleggers.
- The collection costs of the cigarette tax are higher than for most taxes because of the discounts given to distributors for af-

fixing indicia. The reduction of collection costs could possibly provide a source of funds to finance increased enforcement efforts.

- The empirical analysis in this report tends to support results of earlier studies that found that tax-related variables significantly affect per capita sales variations among the States. In particular, high cigarette tax rates are highly associated with low per capita sales, and vice versa. This study finds that many States are only minimally affected by smuggling. This result is explained partially by the fact that the gains and losses from casual smuggling in many States offset each other and interstate bootlegging activity is concentrated in the highest and lowest taxing States. It is also noted that much of the variation in per capita sales is not due to cigarette bootlegging but to social and demographic factors. For example, Utah has the lowest per capita consumption in the Nation because the Mormon religion discourages smoking.
- The majority of the States lose cigarette tax revenues because of bootlegging activities and revenue losses are larger than revenue gains (13 States lose as much as 10 percent of total cigarette tax revenue). The end result is that the Nation's net revenue loss due to bootlegging was an estimated \$337 million in fiscal year 1975. This result is explained partially by the interstate bootlegging factors, which reduce sales in a large number of high-tax States and increase sales in the few low-tax States, and high-tax States lose more per pack in taxes than low-tax States gain per pack.

#### POLICY RECOMMENDATIONS

Despite some recent improvement on the enforcement front, State and local officials have not been able to materially reduce the flow of illicit cigarettes across State lines. State and local law enforcement agencies are hampered

by a lack of resources, weak State laws, lack of jurisdiction in other States, and public indifference to victimless crime. The States can and should take action to strengthen their laws, work for greater cooperative efforts, and increase the resources devoted to cigarette tax law enforcement. However, only the Federal Government has the authority and resources required to operate in a coordinated manner in all States affected by cigarette bootlegging. Cigarette smuggling is an interstate problem because organized crime and other bootleggers take advantage of the States' limited jurisdiction, and an effective solution requires Federal legislation making interstate transportation of illicit cigarettes a Federal offense.

The Commission believes that the States can make a greater effort to enforce cigarette tax laws, but that the problem of cigarette bootlegging cannot be effectively resolved without Federal assistance. The recommendations that follow are designed to encourage joint Federal-State cooperative actions that hopefully will result in a significantly reduced level of cigarette bootlegging.

#### Recommendation 1

##### Federal Contraband Legislation and Cooperative State Enforcement Efforts

The Commission concludes that large State cigarette tax differentials and the difficulty in controlling the interstate flow of contraband cigarettes have created an environment conducive to the large-scale involvement of organized crime in cigarette bootlegging. As a result, many States have incurred substantial revenue losses and the legitimate tobacco industry in the high-tax States also has suffered substantial losses. **The Commission therefore recommends four remedial actions:**

1. The States, especially those that have serious bootlegging problems, should examine carefully the adequacy of their enforcement efforts and, to the extent necessary, should take strong action both to strengthen their law enforcement efforts and to increase the penalties for

the illegal sale or possession of cigarettes. In addition, States should recognize that increases in tax rates that widen cigarette tax rate disparities create profitable opportunities for organized crime involvement in cigarette bootlegging and, therefore, should exercise restraint in formulating cigarette tax rate policy.

2. The high-tax States should enter into cooperative agreements with low-tax States for detecting and reporting unusually large cigarette purchases that appear to be intended for illegal sale in high-tax States.
3. In order to enhance the effectiveness of cooperative efforts, the Congress should give early and favorable consideration to legislation prohibiting the transportation of contraband cigarettes in interstate commerce. (A proposed bill is included in Appendix C.)
4. The Congress should monitor the effectiveness of State and Federal enforcement efforts and State actions to reduce the disparity in cigarette tax rates.

This policy represents a middle-of-the-road approach and also stands as the next logical step that the Federal Government should take in helping the States with this "most troublesome State tax problem."

Any action that reduces organized crime involvement in cigarette bootlegging should be viewed as a positive step by both high- and low-tax States. There is some evidence that organized crime has bought tobacco wholesale businesses in North Carolina, and once organized crime infiltrates one business, there is reason to believe that it will attempt to expand into other areas. This could create a highly undesirable situation in the low-tax States.

This approach is supported strongly by the Federation of Tax Administrators as the Federal instrument of choice in combatting organized crime in this tax field.

Some question remains as to how effective Federal legislation and increased State enforcement efforts will be in curtailing cigarette

bootlegging activity. As a result, the Congress should closely monitor the situation in the event that stronger Federal action, such as a Federal tax credit designed to promote uniform State tax rates, might be required in the future.

### Recommendation 2

#### Encourage Cooperation Between State Tax Officials and Indian Leaders to Facilitate Collection of State Cigarette Taxes

The Commission concludes that the bootlegging of cigarettes from Indian reservations is a problem in several western States. The Commission therefore recommends that State tax officials attempt to reach an agreement with Indian leaders for precollection of the cigarette tax on cigarettes sold on Indian reservations. The State should agree to refund the tax paid by residents of the reservation, based on a mutually agreeable formula.

Five western States have listed the purchase of tax-free cigarettes on reservations by non-Indians as their major tax evasion problem. In Washington State, where the largest revenue problem exists, this revenue loss was estimated at over \$10 million in 1975.

The courts have restricted the States' taxing powers on Indian reservations but have recently ruled that the cigarette tax should be imposed on sales to non-Indians. This problem has been solved in Minnesota by precollection of the tax and refunding of the cigarette tax to the Indians on the basis of average State per capita consumption times the population of the Indian reservation.

In South Dakota, the Indian tribes passed legislation enabling the State Department of Revenue to precollect the tax on cigarettes sold to Indians on the reservation. The Indian tribes have also imposed a tax on cigarettes at the same rate as the State tax and have authorized the State Commissioner of Revenue to collect their taxes on reservation sales. The major barrier to State-Indian cooperative effort is the loss of cigarette sales by Indian smoke shops if their cigarette price includes the State cigarette tax.

### Recommendation 3

#### Strengthen State Cigarette Tax Laws

The Commission concludes that most State cigarette tax laws do not adequately cover bootlegging activity and have weak penalty provisions. The result is that law enforcement efforts are hampered and bootlegging activity is not deterred. The Commission therefore recommends that officials in those States affected by cigarette smuggling examine their statutes and, where appropriate, broaden these laws to make a felony any act involving the shipment, sale, and possession of a substantial number of contraband cigarettes and to increase the penalty provisions. The Commission further recommends that State and local officials consider the transfer of criminal penalty provisions from tax law to penal law.

The penalties for cigarette smuggling are not very heavy. Most States classify violations as misdemeanors—only nine States classify violations as a felony. Very few States impose a punishment that could be considered a real deterrent to violators. As might be expected, the penalties in low-tax States are exceptionally light, but even the high-tax States with serious bootlegging problems do not, in most cases, levy substantial penalties on violators, such as heavy fines and long prison terms. For example, enforcement officials in many States lack the authority to confiscate vehicles used to transport illegal cigarettes. The lack of strong, uniform laws against cigarette smuggling is a serious handicap to law enforcement officials.

The transfer of criminal penalty provisions from tax law to penal law has been urged by some enforcement agents and prosecutors who believe such a change would result in a substantial improvement in cigarette tax compliance and judicial enforcement of the laws. Underpinning this recommendation is the belief that judges might be inclined to impose more severe penalties if cigarette tax violations were covered by the penal code. It should be noted, however, that some people argue that cigarette smuggling is not a serious crime and violators should not be subject to heavy penalties.

### Recommendation 4

#### Establish Education Programs to Increase Public Awareness of the Consequences of Cigarette Smuggling Activities

The Commission concludes that the public has little knowledge about the nature and consequences of cigarette smuggling and that many judges, legislators, and enforcement officials view this act as a victimless crime. This attitude, in turn, has opened the way for the large-scale involvement of organized crime in cigarette smuggling. The Commission therefore recommends that State and local governments develop public information programs to aid in the enforcement of cigarette tax laws.

The public is not aware of the serious nature of cigarette bootlegging and the type of criminal engaged in these activities. Surprisingly many judges, legislators, and even law enforcement officials view cigarette smuggling as a minor, victimless crime and do not provide sufficient support to the tax administrators and law enforcement officials who are attempting to enforce cigarette tax laws. Some knowledgeable experts have suggested that intensive public education campaigns should be launched to inform the public about the serious nature of bootlegging and enlist their support in enforcing cigarette tax laws. The end result could be less casual smuggling and the imposition of stricter penalties for organized smuggling.

The following quote from a 1973 New York report on cigarette smuggling testifies to the importance of public cooperation.

It must be pointed out that the success and profit of cigarette bootlegging depend to a large extent upon the public's indifference and, indeed, its shameful cooperation. While it may be true that a majority of the people who purchase untaxed cigarettes may not realize that organized crime is a major mover of bootleg cigarettes, they certainly have some idea that these cigarettes are sold in violation of the law. The people who smoke cigarettes should be informed by the Public Rela-

tions Bureau of the New York State Department of Taxation and Finance that vast sums of public tax revenue are lost through the purchase of untaxed cigarettes. The people should be requested to remove their blindfolds when purchasing cigarettes and to look carefully for the proper markings on the package of cigarettes purchased to see that the State and city cigarette taxes have been paid. After all, these tax revenues should be serving their public needs and not the racketeers.<sup>2</sup>

### Recommendation 5

#### Extend State and Local Cigarette Taxes to Military Bases

In a recent report, *State Taxation of Military Income and Store Sales*, this Commission concluded that the current exemption from State and local taxation of on-base sales to military personnel should be removed. The Commission recommended that Congress give early consideration to legislation amending the Buck Act to allow the levying of State and local sales and excise taxes on all military store sales in the United States. **Pending the complete removal of the State and local sales tax exemption for military sales, the Commission urges, as a first step, that the Congress enact legislation allowing State and local governments to extend the cigarette tax and the sales tax on cigarettes to sales of cigarettes on military installations.**

The revenue loss to State governments from the military sales exemption was estimated by the Commission at \$266.2 million in fiscal year 1973, of which \$130.2 million was due to the exemption of cigarette sales from State and local taxes. This exemption is a fringe benefit provided to military personnel that is financed by State and local governments. It is a fringe benefit that is available only to those personnel who smoke. Cigarettes, however, cannot be viewed as a necessity nor as a major budget item, and the imposition of State and local taxes will not create a significant hardship on military personnel. The Federal Government imposes the Federal cigarette tax on military

sales and State and local governments should be extended the same authority.

The extension of the cigarette tax to military bases will remove a source of bootleg cigarettes and will increase revenues in several States by an amount sufficient to allow a 1 or 2 cent reduction in the State cigarette tax or, alternatively, to fund greater enforcement efforts to combat other cigarette bootlegging activities.

#### FOOTNOTES

<sup>1</sup>Arkansas, Connecticut, Florida, Illinois, Massachusetts, Minnesota, New Jersey, New York, Ohio, Pennsylvania, Tennessee, Texas, Washington, and Wisconsin. (These States contain about one-half of the U.S. population.)

<sup>2</sup>Fifteenth Annual Report of the Temporary Commission of Investigation of the State of New York (Albany, N.Y.: April 1973) p. 134.

#### Chapter 2

## The Nature and Causes of Cigarette Bootlegging

In the past decade, the bootlegging of illicit cigarettes has become the most difficult revenue enforcement problem facing many States. The estimated revenue losses to State and local governments run into the hundreds of millions of dollars annually. (ACIR estimates are shown in Chapter 7, Table 19.) This problem has become of increasing concern as tax differentials have widened and the cigarette tax has become a more important State revenue source. As Table 1 indicates, State cigarette tax collections did not exceed Federal collections until about 1970. Between 1960 and 1975, Federal collections increased only 21.4 percent, while State collections increased 253.2 percent.

Most State revenue departments are ill-equipped to combat this type of criminal activity and a number of States have appealed to the Federal Government for assistance in the form of legislation prohibiting the interstate transportation of contraband cigarettes. The States, with some exceptions (notably the tobacco-producing States), view cigarette bootlegging as an intergovernmental problem that cannot be solved without full cooperation among the States themselves and the Federal Government. Those opposed to Federal intervention generally contend that enforcement of a State tax is not a matter of Federal concern, and along with the power to levy excise taxes, the States must accept responsibility for their enforcement.

There is little disagreement that bootlegging is caused by the wide disparity in the price of cigarettes in various States. This disparity is largely due to the wide differences in tax rates imposed on cigarettes by State and local governments. The cigarette tax rate ranges from 2 cents per pack in North Carolina to 21 cents per pack in Connecticut and Massachusetts.<sup>1</sup> (See Table 2.) This wide variation makes it very profitable to purchase cigarettes in a low-tax State such as North Carolina and sell them illegally in Connecticut or Massachusetts—this 19 cent variation in the cigarette tax results in a \$1.90 difference per carton of cigarettes. Because it is generally agreed that it becomes profitable to bootleg cigarettes when the price differential is 10 cents per pack (\$1 per carton), this large difference provides a substantial profit opportunity for those willing to engage in the illegal transportation of cigarettes.<sup>2</sup>

#### TYPES OF TAX EVASION ACTIVITIES

There are four distinct types of cigarette smuggling or tax evasion activities that the States must deal with.

**Casual Cigarette Smuggling.** This type of smuggling usually takes place across the borders of neighboring States. In its most common form, a resident of a high-tax State who lives near the border of or is on vacation in a low-tax

State will buy cigarettes for personal use or for friends. A person remains a casual smuggler until he or she starts selling cigarettes for profit, in which case this activity is considered an organized criminal enterprise.

A survey conducted by the Battelle Law and Justice Study Center in 1975 for the Law Enforcement Assistance Administration (hereafter referred to as the Battelle-LEAA survey) indicated that in four States, casual cigarette smuggling is the primary smuggling problem, while it is the second greatest smuggling problem in seven States.<sup>3</sup>

**Organized Cigarette Smuggling.** This activity involves the transportation of cigarettes between States for profit. This type of smuggling can range from a small, part-time operation to a large-scale business run by organized crime figures. This type of smuggling is of greatest concern to the States. According to the Battelle-LEAA survey, organized cigarette smuggling is a major problem for 10 States.

A related problem is the counterfeiting of State cigarette stamps, which has become more prevalent in recent years. Of the States responding to the Battelle-LEAA survey, eight indicated that there was evidence or they suspected that stamps were being counterfeited or forged in their State.<sup>4</sup> In addition, the State of Washington indicated that cigarettes were being sold without tax stamps.

Counterfeiters illegally purchase unstamped cigarettes in low-tax States by paying the State taxes on the cigarettes and then giving the

wholesale agent a premium of up to \$10 per case to purchase the cigarettes without stamps. The cigarettes are then transported to high-tax States, stamped with counterfeit stamps, and distributed through legitimate channels in collusion with reputed legitimate retailers, vending machine operators, and wholesalers.

**Mail-Order Purchase of Cigarettes.** This type of smuggling involves the transportation of cigarettes through the mails from low-tax States to high-tax States for the purpose of avoiding the tax in high-tax States. The Jenkins Act was passed by the Congress in 1949 to prevent this form of tax evasion, and because of increased Federal enforcement of this act and the mail fraud statutes, mail-order smuggling is on the decline, although not eliminated. In recent years, the use of the mail fraud statutes has been the major reason for the decline of mail-order smuggling. One State reported in the Battelle-LEAA survey that this is their main cigarette smuggling problem and eight States reported that it is their second ranking smuggling problem. (See Table 3.)

**Purchase of Cigarettes Through Tax-Free Outlets.** Untaxed cigarettes can be obtained from three primary sources: international points of entry, military post exchanges (PXs), and Indian reservations. The first source has created few problems for the States, although one State reported in the Battelle-LEAA survey significant smuggling from Mexico.

The purchase of tax-free cigarettes from military installations results in significant revenue

Table 1

### Comparison of Federal and State Cigarette Tax Collections, Selected Years 1950-75

Year Ending June 30	Federal Cigarette Tax Collections (\$1,000)	State Cigarette Tax Collections (\$1,000)	State Collections as Percent of Total Collections
1950	\$1,242,845	\$ 413,691	25.0%
1955	1,504,196	470,225	23.8
1960	1,863,561	929,936	33.3
1965	2,069,695	1,327,081	39.1
1970	2,036,101	2,368,077	53.8
1975	2,261,116	3,284,660	59.2

Source: ACIR staff compilation from data in, Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol. 10, Table 3, p. 6; Table 5, p. 8.

Table 2  
Cigarette Tax Rates and Per Capita Sales by State, 1975-76

State	Cigarette Tax Rate Per Pack <sup>1</sup> (in cents)	Sales Tax Per Pack <sup>2</sup> (in cents)	Per Capita Sales FY 1975 (in packs)
Alabama	12	2	111.7
Alaska	8	-	150.4
Arizona	13	2	121.8
Arkansas	17.75	-	114.8
California	10	3	127.1
Colorado	10	-	131.0
Connecticut	21	-	110.2
Delaware	14	-	147.6
District of Columbia	13	3	176.5
Florida	17	3	131.9
Georgia	12	1	122.9
Hawaii	11	2	92.4
Idaho	9.1	1	123.3
Illinois	12	2	131.8
Indiana	6	1	162.4
Iowa	13	2	120.5
Kansas	11	2	123.4
Kentucky	3	2	223.0
Louisiana	11	2	133.6
Maine	16	-	140.7
Maryland	10	2	146.1
Massachusetts	21	-	126.1
Michigan	11	2	136.8
Minnesota	18	-	111.5
Mississippi	11	2	116.8
Missouri	9	1	135.6
Montana	12	-	123.7
Nebraska	13	1	114.1
Nevada	10	1	205.2
New Hampshire	12	-	269.1
New Jersey	19	-	122.3
New Mexico	12	2	103.1
New York	15	2	123.9
North Carolina	2	2	226.0
North Dakota	11	2	117.9
Ohio	15	-	122.5
Oklahoma	13	-	132.9
Oregon	9	-	154.4
Pennsylvania	18	-	114.6
Rhode Island	18	-	154.7
South Carolina	6	2	130.5
South Dakota	12	-	113.5
Tennessee	13	2	117.4
Texas	18.5	-	116.0
Utah	8	2	75.8
Vermont	12	-	155.5
Virginia	2.5	2	152.7
Washington	16	3	99.5
West Virginia	12	2	123.2
Wisconsin	16	2	113.5
Wyoming	8	-	160.7

<sup>1</sup>As of July 1, 1976.

<sup>2</sup>As of November 1, 1975. Refers to single package sales only, tax per pack on carton lot sales is lower in most States.

Source: ACIR staff compilation from data in, Tobacco Tax Council, Inc., *Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol. 10, Table 7, p. 10; Table 11, p. 22; Table 15, p. 91.

Table 3  
Types of Smuggling Problems in the States  
Question I-C: Are cigarettes being smuggled into your State?  
(If yes, please rank the sources, 1 = highest)  
(N = 27)

Source	Number of States Ranking			
	1	2	3	4
Other States	18	3	2	-
Military PXs <sup>1</sup>	3	5	7	6
Indian Reservation	4	1	-	-
Hijacking	2	4	5	6
Mail Order	1	8	4	3
Other	-	2	1	-

<sup>1</sup>Two States did not complete question but indicated a small problem with purchases from military PXs.  
Note: Ranking totals do not equal total respondents because some States did not rank all sources.  
Source: ACIR staff compilation from questionnaire used in the Battelle-LEAA survey, 1976.

losses in many States. (See Appendix Table A-6.) The Battelle-LEAA survey found that eight States ranked sales from PXs as their first or second most serious problem. (See Table 3.)

The tax-free purchase and subsequent illegal sale of cigarettes from Indian reservations is a major problem in western States. The Battelle-LEAA survey indicated that five States considered this a major cigarette tax evasion problem.

STATE TAX DIFFERENTIALS

Cigarette bootlegging did not become a serious problem for State and local governments until the late 1960s, because prior to that time, the price differential was not wide enough to encourage such activities. In 1960, the largest difference in cigarette taxes between any two States was 8 cents and the widest variation in the retail price of cigarettes was about 10 cents. The price differential between North Carolina and New York was only 5.2 cents per pack. (See Appendix Table A-3.)

By 1965, the largest variation in cigarette tax rates had increased to 11 cents per pack and the variation in retail price to 12.9 cents. The largest variation in retail price was between North Carolina and New York. In only 5 years, the price differential between these two States had increased by 7.7 cents; 5 cents of the difference

was due to an increase in the New York cigarette excise tax.

A combination of the Surgeon General's 1964 report on smoking and health and the fiscal problems in many northeastern and mid-western States led to large rate increases in many States. The tobacco-producing States, however, maintained their tax rates at a low level. (See Table 4.) As a result, by 1970 the high and low cigarette tax States were separated by 16 cents—2 cents in North Carolina and 18 cents in Pennsylvania. The largest retail price differential in 1970 was 16.5 cents.

Cigarette tax rates in 1976 ranged from 21 cents in Connecticut and Massachusetts to 2 cents in North Carolina. The retail price of cigarettes, including taxes, varied from 57.6 cents in Connecticut to 35.8 cents in North Carolina—a 21.8 cent difference. The price differential between New York and North Carolina was 18.4 cents.

The large differentials in cigarette taxes are mainly among the low-tax, tobacco-producing States and the high-tax northeastern States. The tax rates in 39 States fall between 8 and 17.75 cents. It is the States at the extremes, however, that create the serious bootlegging problem. (See Table 5.)

Between 1973 and 1975, only five States increased their cigarette tax rates compared with an increase in 26 States between 1970 and

1973. Four increases since 1973 were in States with below-average tax rates. (See Table 6.)

The experience of the past few years indicates that cigarette tax rates may be beginning to stabilize after rising sharply and frequently during the past 10 years. It is not completely clear whether this stabilization can be attribut-

ed to the States' greater concern with the bootlegging situation. The New York State Special Task Force on Cigarette Bootlegging has recommended that the State tax be reduced 2 cents and the New York City tax be eliminated for the purpose of curtailing bootlegging activity. These developments provide some hope that the

Table 4  
The Growing Disparity In State Cigarette Tax Rates  
(January 4, 1965—July 1, 1976)

Cents per Standard Pack of 20	Number of States as of			
	January 1 1965	January 1 1968	January 1 1970	July 1 1976
No tax	2	2	0	0
2	2 <sup>1</sup>	1 <sup>1</sup>	1	1
2.5	1	1	2	1
3	3	2		1
3.5	1			
3.9	1			
4	4	2	2 <sup>1</sup>	
4.5		1		
5	5	3	1	
6	9	3	3	2
7	7	7	4	
8	15	2	9	3
9	1	1	2	3
10		3	5	4
11		2	3	6
12			8	9
12.25			1	
13			5	6 <sup>1</sup>
14			2	1
15			1	2
15.5			1	
16			1	3
17				1
17.75				1
18				3
18.5				1
19				1
21				2
Median Tax Rate	6	8	10	12

<sup>1</sup>Includes the District of Columbia.  
Note: Rates stated as a percentage of the wholesale or retail price, as in the case of New Hampshire and Hawaii, are translated into the equivalent cents per pack.  
Source: Commerce Clearing House, State Tax Reporter (Chicago, Ill.: 1978).

**Table 5**  
**Distribution of Cigarette Tax Rates**  
(as of July 1, 1976)

0 - 6 cents—	5 States
7 -10 cents—	10 States
11-14 cents—	22 States
15-18 cents—	10 States
19 + cents—	4 States

Source: ACIR staff compilation from Table 4.

bootlegging problem will not be exacerbated by an ever-widening gap in cigarette tax rates.

#### Cigarette Sales in the Northeast

The most serious bootlegging problem appears to be in the Northeast and to have developed in the past decade. Per capita sales figures for this area are compared with per capita sales figures for the low-tax, southern States in Table 7. The southern States are generally regarded as the source of bootleg cigarettes sold in the Northeast.

During the relatively stable tax period of the 1960s, per capita consumption in the Northeast did not decline as fast as the average for all taxing States. The large increase in Kentucky between 1960 and 1965 is probably attributable more to casual smuggling into higher tax, border States than to organized bootlegging.

During the 1965-70 period, an analysis of the per capita sales figures points to the beginning of an organized bootlegging problem in the Northeast. It is not coincidental that this was

also the period in which cigarette tax rates in the Northeast began to rise sharply.

Because of the health scare, most States suffered a decline in per capita sales between 1965 and 1970. The declines in per capita sales are significantly greater in the northeastern States than in the United States as a whole. The two southern States in Table 7, for which data is available, countered the downward trend. The 21 percent increase in Kentucky suggests a substantial outflow of bootleg cigarettes.

Between 1970 and 1975, cigarette consumption exhibited an upward trend—U.S. per capita consumption increased 10.6 percent. None of the five northeastern States included in Table 7 came close to matching the increase in the U.S. average. The three low-tax, tobacco-producing States, however, recorded sales gains well in excess of the U.S. average. The 43.1 percent gain in Kentucky, the 31 percent gain in North Carolina, and the 22.8 percent increase in Virginia are well above the historical growth trends of these States.

It is interesting to note that the smallest per capita gains or largest losses in sales occurred in those States that raised their cigarette tax by the largest amount. Only one of the northeastern States failed to raise the cigarette tax during the 1970-75 period, and that State—Pennsylvania—recorded the largest increase in per capita sales of the five northeastern States shown in Table 7. (The increase in Pennsylvania can also be attributed to increased law enforcement efforts and the fact that the bordering State of New Jersey increased its tax rate.)

This data appears to support the conclusion

**Table 5**  
**Changes in State Cigarette Tax Rates, 1955-75**

Fiscal Year ended June 30	Total Actions	Number of Tax Increases	Number of Tax Decreases	New Enactments
1955-1960	47	42	1	4
1960-1965	46	42	2	2
1965-1970	58	55	1	2
1970-1975	34	34	0	0
1973-1975	5	5	0	0

Source: ACIR staff compilation from data in, Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol. 10, Table 6, p. 9; Table 7, p. 10.

that the organized bootlegging activities that began to surface in the mid-1960s has continued unabated in recent years. The data also offer strong evidence that there is a high correlation between a State's tax rate and the level of bootleg activity in that State.

Using Ohio as an example, Chart 1 illustrates the impact of cigarette tax increases on per capita cigarette sales. In September 1967, Ohio increased its cigarette tax rate from 5 to 7 cents. Per capita sales fell 4.8 percent in fiscal year 1968—exactly double the decline in U.S. sales during the same period.

In August 1969, Ohio raised its cigarette tax rate from 7 to 10 cents. In fiscal year 1970, per capita sales declined 5.6 percent compared with a 2.2 percent drop in U.S. per capita sales.

In December 1971, Ohio raised the cigarette tax rate from 10 to 15 cents. Again, per capita sales dropped—3.3 percent between fiscal years 1971 and 1973 compared with a 3.6 percent increase in U.S. per capita sales.

Ohio per capita sales were higher than the U.S. average until shortly after Ohio increased the tax rate to 15 cents. In 1966, when the Ohio tax rate was 5 cents (almost 2 cents below the

U.S. average), Ohio per capita sales were 8.8 percent above the U.S. average. In 1975, when the Ohio tax rate was almost 3 cents above the U.S. average, per capita sales in Ohio were 6.4 percent below the U.S. average. Cigarette sales in Ohio may be particularly sensitive to rate increases because the bordering States of Indiana and Kentucky have a tax rate of 6 cents and 3 cents, respectively.

A portion of the decline or the small gains in sales in the northeastern States can be explained by the impact of price increases on the quantity of cigarettes demanded. However, most studies have found that cigarettes are price inelastic—a 1 percent increase in price will result in a less than 1 percent decline in sales. Although it is difficult to separate the income effects from the price effects, it appears that the weakness in sales in the Northeast is greater than can be explained by price increases.

#### Cigarette Tax Rates and Per Capita Sales

A State's per capita cigarette sales and its cigarette tax rate are highly correlated. (See

**Table 7**  
**Per Capita Cigarette Sales in Packs for Selected States**  
(State Tax Rate in Cents in Brackets)

State	1960	1965	Percent Change	1970	Percent Change	1975	Percent Change
Connecticut	153.7(3)	147.0(6)	-4.4%	24.8(16)	-15.2%	110.2(21)	-17.8%
Massachusetts	131.1(6)	136.5(8)	+4.1	124.3(12)	-9.0	126.1(16)	+1.4
New Jersey	141.1(5)	138.0(2)	-2.2	120.7(14)	-12.6	122.3(19)	+1.3
New York	145.0(5)	138.5(10)	-4.5	119.0(12)	-14.1	123.9(15)	+4.1
Pennsylvania	119.2(6)	120.4(8)	+1.0	107.3(18)	-10.9	114.6(18)	+6.8
Kentucky	113.6(3)	128.7(2.5)	+13.2	155.8(2.5)	+21.0	223.0(3)	+43.1
North Carolina	—	—	—	172.4(2)	—	226.0(2)	+31.0
Virginia	—	123.3(3)	—	124.3(2.5)	+0.8	152.7(2.5)	+22.8
U.S. Average	37.1	126.8	-7.6	118.3	-6.8	130.9	+10.6

Source: ACIR staff compilation from data in, Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol. 10, Table 11, p. 22.



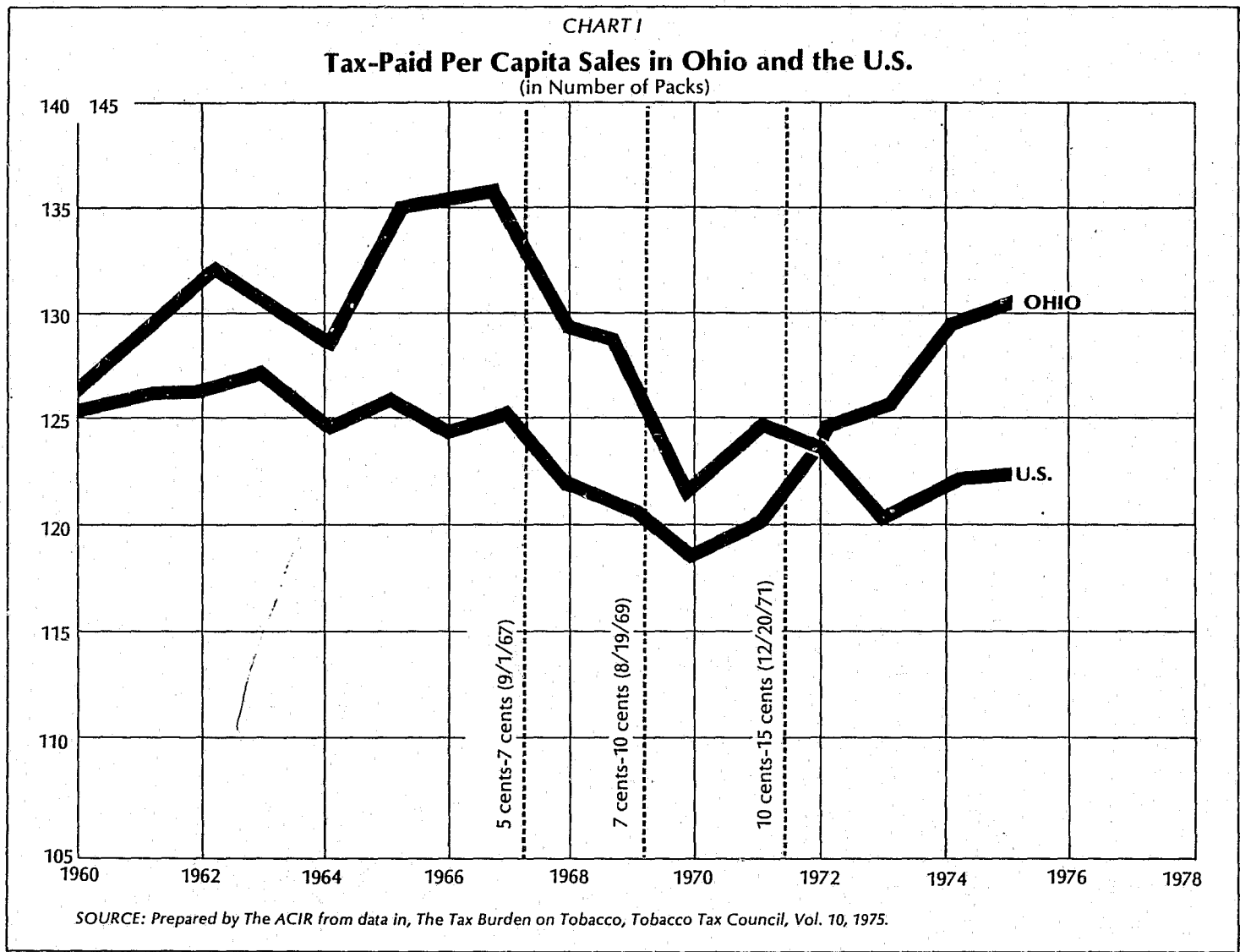


Table 8.) All but three of the high-tax States have per capita consumption well below the U.S. average. The exceptions are Florida, Maine, and Rhode Island. Florida's per capita cigarette sales are slightly above the U.S. average, but because of Florida's tourist trade, per capita sales should be well above the U.S. average. Tourism tends to inflate per capita sales figures. This is also the probable cause of the higher than average sales in Maine. In 1972, Maine hotel and motel receipts per capita (a proxy for tourism) were 37.6 percent above the

national average. Rhode Island's per capita sales are well above the U.S. average despite a high tax rate. This situation can probably be explained by the fact that Rhode Island, a small State, is bordered by two populous States with higher cigarette tax rates. In all but three cases, per capita sales in the low-tax States are well above the U.S. average. Two of the exceptions—Idaho and Utah—can be explained by their large Mormon population, because most disciples of the Mormon religion do not smoke. The South Carolina ex-

Table 8 Comparison of Per Capita Sales in High and Low Cigarette Tax States, FY 1975	
High-Tax States (15 cents or more)	Per Capita Sales as Percent of U.S. Average
Arkansas	87.7
Connecticut	84.2
Florida	100.8
Maine	107.5
Massachusetts	96.3
Minnesota	85.2
New Jersey	93.4
New York	94.6
Ohio	93.6
Pennsylvania	87.5
Rhode Island	118.2
Texas	88.6
Washington	76.0
Wisconsin	86.7
Unweighted Average	92.9
Low-Tax States (9 cents or less)	
Alaska	117.6
Idaho	94.2
Indiana	124.1
Kentucky	170.3
Missouri	103.6
North Carolina	172.6
Oregon	117.9
South Carolina	99.7
Utah	57.9
Virginia	116.6
Wyoming	122.8
Unweighted Average	117.9
Source: ACIR staff compilation from data in Tobacco Tax Council, Inc., <i>The Tax Burden on Tobacco</i> (Richmond, Va.: 1975) Vol. 10 Table 11, p. 22.	

ception, where sales are slightly below the U.S. average, is explained by its bordering on North Carolina, which has the lowest tax rate in the Nation.

Cigarette bootlegging has caused a significant shift in per capita cigarette sales among the States. (See Table 9.) In 1955, cigarette sales in the northeastern States were well above the national average, while sales in the southern States were consistently far below the national average. This large divergence was due largely to economic and cultural factors because there was little evidence of cigarette smuggling in 1955. By 1965, the cigarette sales pattern had

begun to change in favor of the southern States, although sales were still significantly higher in the northeastern States. Ten years later, widespread cigarette smuggling had reduced cigarette sales in the northeastern States to well below the national average, while sales in several southern States had risen substantially above the national average. To illustrate, per capita cigarette sales in Kentucky were 15.4 packs below the U.S. average in 1955, 1.9 packs above the U.S. average in 1965, and 92.1 packs above the U.S. average in 1975. During the same period, per capita sales in New York dropped from 21.4 packs above the U.S.

average to 7 packs below the U.S. average.

The coefficient of dispersion for per capita cigarette sales, included in Table 9, is used to test whether or not cigarette sales have diverged further from the mean because of cigarette bootlegging. The coefficient is obtained by dividing the sum of the variances from the mean by the mean. The coefficient of dispersion has increased since 1955, but not as much as might be expected. This finding indicates that although cigarette smuggling has increased the divergence in cigarette sales, economic and social factors, such as religion, income, and tourism, are still responsible for a large share

of the difference in per capita cigarette sales among the States.

UNFAIR CIGARETTE SALES LAWS

Although tax differentials are responsible for most variances in the price of cigarettes, unfair sales laws also can affect the variances. For example, cigarettes in a State without an unfair sales law often sell at a lower price than cigarettes in a State with an unfair sales law, even though the tax rate may be higher in the former State. As of January 1, 1975, 18 States had laws of this type; an additional 21 States

Table 9 Variance in State Cigarette Per Capita Sales From U.S. Average, FY 1955, 1965, 1975 [Below U.S. Average (-)]			
State	1955 (in packs)	1965 (in packs)	1975 (in packs)
Alabama	-31.0	-28.3	-19.2
Alaska	—	-22.6	19.5
Arizona	3.7	- 3.6	- 9.1
Arkansas	-43.1	-26.5	-16.1
California	—	13.2	- 3.8
Colorado	—	4.7	0.1
Connecticut	27.1	20.2	-20.7
Delaware	29.1	44.0	16.7
District of Columbia	30.8	99.7	45.6
Florida	16.5	4.3	1.0
Georgia	-16.3	-23.0	- 8.0
Hawaii	—	-43.4	-38.5
Idaho	-13.9	-31.6	- 7.6
Illinois	9.6	18.7	0.9
Indiana	3.4	8.5	31.5
Iowa	-15.5	-10.8	-10.4
Kansas	-12.5	-19.0	- 7.5
Kentucky	-15.4	1.9	92.1
Louisiana	-22.0	- 9.3	2.7
Maine	25.0	12.3	9.8
Maryland	—	- 5.8	15.2
Massachusetts	8.7	9.7	- 4.8
Michigan	12.2	5.0	5.9
Minnesota	-13.9	-17.6	-19.4
Mississippi	-34.6	-43.2	-14.1
Missouri	—	3.4	4.6
Montana	10.3	- 8.8	- 7.1
Nebraska	- 7.3	-16.3	-16.8
Nevada	76.4	65.9	74.3
New Hampshire	54.4	107.0	138.2
New Jersey	22.4	11.2	- 8.6
(Continued)			

Table 9 (continued) Variance in State Cigarette Per Capita Sales From U.S. Average, FY 1955, 1965, 1975 [Below U.S. Average (-)]			
(State continued)	1955 (in packs)	1965 (in packs)	1975 (in packs)
New Mexico	-16.0	-30.5	-27.8
New York	21.4	11.7	- 7.0
North Carolina	—	—	- 7.0
North Dakota	-28.9	-23.6	-13.0
Ohio	9.2	8.0	- 8.4
Oklahoma	-13.9	-11.2	2.0
Oregon	—	—	23.5
Pennsylvania	- 4.5	- 6.4	-16.3
Rhode Island	33.7	6.4	23.8
South Carolina	-27.0	-23.7	- 0.4
South Dakota	-17.1	-28.1	-17.4
Tennessee	-26.8	-18.7	-13.5
Texas	1.0	- 6.3	-14.9
Utah	-46.4	-61.8	-55.1
Vermont	13.9	3.9	-24.6
Virginia	—	3.5	21.8
Washington	- 1.4	-28.5	-31.4
West Virginia	-27.5	-16.3	- 7.7
Wisconsin	- 7.2	-17.4	-17.4
Wyoming	25.5	10.8	29.8
Coefficient of Dispersion <sup>1</sup>	8.09	8.43	8.56
Range of Tax Rates	0-8 cents	0-11 cents	2-21 cents
<sup>1</sup> The coefficient of dispersion is calculated by dividing the sum of the variances by the mean. It is used to measure the degree of variance from the mean. The higher the number, the greater the degree of variance. Source: ACIR staff compilation from data in, Tobacco Tax Council, Inc., <i>The Tax Burden on Tobacco</i> (Richmond, Va.: 1975) Vol. 10, Table 7, p. 10; Table 11, p. 22.			

had unfair sales or practice laws. (See Appendix Table A-7.)

Unfair cigarette sales laws prohibit cigarette sales below cost and establish minimum markups which are presumed to reflect business costs. The specified markups are 2 to 5 percent and 6 to 12.4 percent of the basic cost of cigarettes for wholesalers and retailers, respectively. Violators may be subject to injunctions by the State tax commissioner, fines up to \$1,000, imprisonment, and private injunctions and damage suits.

Unfair sales or practice laws apply to cigarettes as well as other goods and, except for their broader scope, are very similar to unfair cigarette sales laws. These laws have no effect on cigarette prices in States with an unfair

cigarette sales law because the latter sets higher markups and is applied more directly. The general laws may have some effect on cigarette prices in States that do not have unfair cigarette sales laws.

In a 1973 doctoral dissertation, Paul Manchester attempted to measure the effect of unfair cigarette sales laws on cigarette prices.<sup>6</sup> He found that the dummy variable used to represent these laws consistently had the wrong sign—the variable contributed to a lower price rather than to a higher price. He concluded that the customary markups probably exceed the minimum specified in these laws and thus unfair sales laws have no effect on retail prices, which would indicate that these laws do not contribute to the bootlegging problem.

#### FOOTNOTES

<sup>1</sup>Massachusetts' cigarette tax rate for 1975 was 16 cents. The 21 cent figure is that State's 1976 tax rate.

<sup>2</sup>"Elimination of Cigarette Racketeering," Hearing before Subcommittee 1 of the Committee on the Judiciary, House of Representatives, Sept. 28, 1972, 92nd Congress, pp. 72 and 77.

<sup>3</sup>Law Enforcement Assistance Administration, U.S. Depart-

ment of Justice, *Combatting Cigarette Smuggling* (Washington, D.C.: Jan. 31, 1976) p. 10.

<sup>4</sup>Florida, Louisiana, Massachusetts, Connecticut, New York, Pennsylvania, Texas, and Wisconsin.

<sup>5</sup>Paul B. Manchester, "An Econometric Analysis of State Cigarette Taxes, Prices, and Demand, With Estimates of Tax-Induced Interstate Bootlegging," a thesis submitted to the University of Minnesota, August 1973, p. 37.

<sup>6</sup>*Ibid.*, p. 18-19.

#### Chapter 3

## Cigarette Smuggling and Organized Crime

All too often, cigarette smuggling is viewed as a victimless crime in which a law-abiding citizen smuggles a few cartons of cigarettes across the border for personal use or for friends. This rather benign view of cigarette smuggling is an accurate picture of the situation in many States, but in about a dozen States (mainly in the East and Midwest), this is a grossly distorted view. In these States, cigarette smuggling is a multi-million dollar business, organized crime syndicates are heavily involved, and there are many victims. State and local governments lose millions of dollars; taxpayers pay higher taxes or receive fewer services; cigarette wholesalers and retailers are driven out of business and jobs are lost; political and law enforcement officials are corrupted; trucks are hijacked and warehouses raided; and people are injured and even killed.

*Newsday*, a Long Island, N.Y., newspaper, conducted a 4-month investigation of cigarette smuggling and concluded, in a series of articles appearing in February 1975, that La Cosa Nostra had become New York State's biggest wholesaler of cigarettes. The *Newsday* investigation also uncovered a number of other important aspects of cigarette smuggling:

- Four New York crime families employing more than 500 enforcers, peddlers, and distributors smuggle an estimated 480

million packs into the State each year. The estimated tax loss from just nine identifiable mob groups in La Cosa Nostra exceeds \$62 million.

- In a nine-State area in the Northeast, the mob, including crime families from New England, Illinois, and Pennsylvania, bootlegs more than a billion packs annually, which creates profits for the mob of more than \$105 million and losses to wholesalers and State tax bureaus of more than \$500 million.
- Because of the huge inroads made by La Cosa Nostra smugglers, more than 2,500 drivers, packers, and salesmen in New York State have lost their jobs and nearly half of New York's legitimate wholesalers have folded. The remaining wholesalers are forced to pay \$600,000 annually for skyrocketing insurance premiums and guards.
- Against an army of mob smugglers, New York City police and tax agents have less than 90 investigators. Of these, a cloud of suspicion has been drawn over the 67-man State tax unit because of reports (under investigation at the time of the article by the State's special prosecutor)

that agents were taking more than \$100,000 a year in mob payoffs.

- Cigarette smuggling provides La Cosa Nostra with millions of dollars for its rackets. Because of the high profits, it also provides motives for armed robbery and murder. Since 1972, four mob smugglers have disappeared and presumably were murdered because they hijacked smugglers' incoming loads or cheated their bosses.

Organized crime involvement is most prevalent in New York State, but there is evidence that this criminal element is involved in cigarette smuggling in about a dozen States.<sup>1</sup> (See Appendix D, Statement of Edward Lorch, for further discussion of New York City's problem of organized crime involvement in cigarette smuggling.)

The profits from organized smuggling of cigarettes are enormous. The Council Against Cigarette Bootlegging<sup>2</sup> estimates that the illegal profits in eight eastern States were about \$97.9 million in fiscal year 1975-76. The profits from cigarette smuggling are used by organized crime to finance other illegal operations, such as drugs, loan sharking, and gambling. These profits are earned at the expense of State and local governments, which, according to the Council, lost an estimated \$170.7 million in revenues in the eight eastern States (Connecticut, Delaware, Maryland, Massachusetts, New York, New Jersey, Pennsylvania, and Rhode Island), and the tobacco industry (wholesalers and retailers), which lost an estimated \$470 million in sales. (ACIR estimates of State revenue losses (Chapter 7, Table 19) are somewhat lower.)

Despite these losses and the strong evidence of organized crime involvement, the public and many public officials remain largely unconcerned. In Illinois, the State revenue commissioner and several of his agents were held in contempt of court after they failed to comply with a judge's order to stop "harassing" people who were smuggling a few cartons of cigarettes into Illinois from Indiana. The Illinois Supreme Court recently overruled the lower court and allowed revenue agents to continue their enforcement activities.

In Washington, D.C., two bills were recently proposed that would prevent surveillance by Maryland and Virginia enforcement agents within 150 yards of any establishment selling alcoholic beverages and tobacco or tobacco products and would limit such surveillance to 15 minutes. The bills also limit surveillance of any business establishment to once a year and require that personnel engaged in surveillance must first register with the Washington, D.C., chief of police. This legislation is aimed largely at out-of-State alcohol beverage agents, but it could hurt cigarette tax law enforcement efforts if enacted in any State.

Cigarette smuggling is considerably more than a minor victimless crime—the economic losses, the revenues lost to local government, and law enforcement costs run into hundreds of millions of dollars annually. Cigarette smuggling attracts hard core criminals, and their activities spread beyond transporting cigarettes across State lines. Some law enforcement officials consider the strengthening of organized crime by cigarette smuggling profits and the demoralization of law-abiding people are more important than the economic losses.

A December 15, 1975 editorial from the *Philadelphia Inquirer* puts this issue in perspective:

In its widening zeal to control cigarette smuggling, the Shapp administration seems to have lost sight of both the real problem and the real cause. As the State Revenue Department views it, the problem is that the State is losing \$30 million a year in taxes. But \$30 million is a relative snowflake on the alps of State spending.

The real problem is that cigarette smuggling is corrupting Pennsylvania's political establishment. The most glaring manifestation of this being—to date—the case of Philadelphia Judge Vito Pisciotto. Pisciotto was convicted last month of using the profits from a cigarette smuggling scheme to "buy" a judgeship.

Three State cigarette agents have been indicted and are awaiting trial in the same case. Federal authorities say hijacking and murder in connection with "bootlegging" have become stan-

dard fare on the interstate highways leading to the South.

As the Shapp administration views it, the cause of all this illicit activity is that organized crime has gotten into the cigarette smuggling business in a big way. The real cause is that the commonwealth of Pennsylvania imposes an 18-cent tax on each pack of cigarettes while North Carolina—less than a day's drive away—taxes at the rate of only two cents per pack.

The difference on a tractor trailer load of 10,000 cartons bought in North Carolina and sold in Pennsylvania is \$16,000. It is hard to imagine a situation more likely to attract organized crime.

*There is another essential ingredient for mob influence—public indifference. The average Pennsylvanian is not duly upset by the tax leakage, and hardly any group seems to care.*

Certainly not the North Carolina wholesalers, who are not about to offend Northern customers who buy 10,000 cartons at a time and pay cash. And certainly not the ultimate purchasers of the contraband cigarettes who save about 15 cents a pack.

Who, then, is upset? For one, the legitimate Pennsylvania retailers who are losing business. For another the State Bureau of Cigarette and Beverage Taxes, whose job it is to collect the revenue.

There is a simple way to end bootlegging. Lower the Pennsylvania tax to a point where smuggling is no longer profitable. Such a step would cost the State Treasury some money, but it would also remove corrupting influences from Pennsylvania's body politic. (Emphasis added.)

In the light of the demonstrated public indifference to cigarette bootlegging, the recent report of the New York State Special Task Force on Cigarette Bootlegging recommended, "an intensive public education campaign utilizing all media be initiated by the Department of Taxation and Finance to aid in the enforcement

of all aspects of the cigarette tax law."<sup>3</sup> Every State that has a cigarette smuggling problem, particularly those where organized crime is involved, should consider initiating a public education campaign. Greater public awareness and concern would be helpful to State and local government efforts to control cigarette smuggling.

## CASE STUDY

This case study is taken from the *Fifteenth Annual Report of the Temporary Commission of Investigation of the State of New York*, which was issued in April 1973.

In the course of its investigation, the New York Commission undertook an indepth study of one well-known, major cigarette bootlegging ring to illustrate organized crime involvement in the cigarette bootlegging problem. Anthony Granata—the central figure of this case study—was convicted of violating New York cigarette tax laws and sentenced to 4 years in prison in the fall of 1976.

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, N.Y. Granata is listed by law enforcement officials as a member of the organized crime family headed by Joseph Colombo. His criminal record reflects 12 arrests, four of which were connected with cigarette bootlegging. He has been convicted of criminally receiving stolen property as well as use of a forged driver's license.

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

Granata operated his business on a professional level with over 30 employees. He was known to have dispatched drivers on a 6-days-

a-week schedule to North Carolina. Orders were placed and all necessary arrangements were handled by clerical employees in New York City. He also employed an expeditor 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 cigarette loads to selected points in Pennsylvania. The short-haul driver would meet the shipment, transfer it to his vehicle, and bring it into New York.

All legal costs arising from the arrests of drivers, such as lawyers fees, bail, and fines, were also handled, wherever the jurisdiction, from Granata's headquarters. Fraudulent driver's licenses and other false identification were supplied. Among other devices used to avoid detection, Granata constructed a truck disguised as a lumber transporter. Dummy corporations also were 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 at which the profits of the business and territorial rights were discussed.

An associate of Granata's, one Robert Li Sante, was called as a witness at the New York Commission's public hearing. In June 1971, Li Sante had been arrested in New Jersey in possession of 4,560 cartons of cigarettes. The records show that he was convicted, received a suspended jail sentence, and paid a \$250 fine. Also arrested at that time was Rocco Granata, father of Anthony. In September 1971, Li Sante was arrested by detectives of the New Jersey State Police. At that 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. Li Sante is known to be an important associate of Granata and was responsible for coordinating orders for cigarettes and their financing and delivery

arrangements. When questioned at both private and public hearings with regard to the above transactions, Li Sante invoked his constitutional privilege against self-incrimination and refused to answer all questions.

Another associate of Granata in the bootlegging operation was Joseph (Sam) Pontillo, also subpoenaed as a witness at the New York 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 1968, Pontillo was apprehended in New Jersey in possession of 2,200 cartons of untaxed cigarettes. In April 1969, after leaving Granata's "drop" or warehouse in New York in possession of 3,600 cartons of untaxed cigarettes, he was again arrested. Available criminal records show that this case was dismissed on the grounds of illegal search and seizure.

At the time of the New York 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 New York Commission's private and public hearings, Pontillo availed himself of his constitutional privilege against self-incrimination and refused to answer any questions.

On 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 New York Commission and introduced 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. Of this number, 41 arrests were for cigarette tax violations. The other crimes ran the 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 opera-

tions 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, almost invariably the charge is dismissed based upon illegal search and seizure.<sup>4</sup>

#### FOOTNOTES

<sup>1</sup>Additional information concerning organized crime involvement in cigarette bootlegging and the level of violence associated with this illegal activity can be found in an unpublished paper prepared by Edward Lorch and Jack Winters of the Intelligence Division of the New York City Police Department—"An Analysis of Untaxed Cigarette Smuggling," Jan. 10, 1975.

<sup>2</sup>The Council is one person—Morris Weintraub, publisher of *Vending Times* and former Managing Director of the Wholesale Tobacco Distributors of New York, Inc. Mr. Weintraub is closely associated with the tobacco industry. <sup>3</sup>*Report of the New York State Special Task Force on Cigarette Bootlegging* (Albany, N.Y.: Dept. of Taxation and Finance, May 1976) p. 16. <sup>4</sup>*Fifteenth Annual Report of the Temporary Commission of Investigation of the State of New York* (Albany, N.Y.: April 1973) p. 31.



## Federal and State Policies

### FEDERAL POLICIES AND ASSISTANCE

The smuggling of cigarettes across State lines is not a Federal offense. The only Federal law applicable to cigarette smuggling is the Jenkins Act (15 USC 375-378), enacted in 1949.

#### Jenkins Act

This act requires persons who ship cigarettes into other States to notify the tobacco tax administrators in these States of the names and addresses of the recipients and of the quantities, brands, and dates of mailing. The act also requires a business to provide tobacco administrators with its name, principal place of business, and the names of the officers of the business. Any person who violates these filing and reporting requirements faces punishment by a fine of not more than \$1,000 and/or imprisonment for not more than 6 months. The act has limited usefulness for attacking the over-the-road smuggling problems that are of greatest concern to the States.

The Jenkins Act together with the U.S. mail fraud law (18 USC 1341) has been successful in curtailing mail-order cigarette smuggling. The Battelle-LEAA study of cigarette smuggling, discussed in Chapter 2, found that only one State considered the mail-order purchase of cigarettes as its major problem, although a

number of States listed mail-order sales as their second most serious smuggling problem.

### Proposed Federal Contraband Legislation

In the past several years, attempts have been made to enact strict Federal legislation aimed at curtailing organized smuggling activities. The most recent legislation was H.R. 701, which was introduced in 1975. The stated purpose of the bill was "to eliminate racketeering in the sale and distribution of cigarettes and to assist State and local governments in the enforcement of cigarette taxes." The bill provided for a fine of up to \$10,000 and 2 years imprisonment for the transportation of contraband cigarettes in interstate commerce. "Contraband cigarettes" are defined as more than 100 cartons in the possession of anyone other than a person legally permitted to possess them. (A bill proposed by ACIR is presented in Appendix C.)

The U.S. Department of Justice, as do officials in the Department of the Treasury and the Congress, has been opposed to this type of legislation in the past. In 1974, the Department went on record in opposition to H.R. 3805, which was almost identical to the 1975 bill. The Department position was outlined in an April 1974 memo to Rep. Peter W. Rodino, Chairman of the House Committee on the Judiciary. The

Justice Department acknowledged the severity of the problem and the involvement of organized crime, but advanced the view that consideration of the bill was premature. The testimony said:

The Department of Justice would like to await the results of these renewed State efforts [refers to New York State Investigative Committee recommendation for greater enforcement effort by the State and City of New York] before introducing the Federal government into what has heretofore been a State area of responsibility. The Department, and indeed the Congress, has always viewed an extension of Federal criminal jurisdiction as a serious step, not to be taken without a convincing showing that a law enforcement problem is beyond the States' capability to control. We feel that enactment of Federal legislation, shortly after a State's [New York] admission of failure to give this problem law enforcement priority, would be unwise.<sup>1</sup>

There is no indication that the Justice Department has changed its opinion on this legislation over the past 2½ years. Cigarette bootlegging has increased in magnitude despite increased enforcement efforts on the part of the States. Federal officials apparently remain unconvinced of the need for Federal contraband legislation. The general view is that the enforcement of cigarette tax laws is a State responsibility, and until there is incontrovertible evidence that the States cannot adequately enforce these laws, the Federal Government will continue to follow a hands-off policy.

Supporters of Federal contraband legislation argue that when an individual State's inability or unwillingness to deal with a problem affects the States' collective welfare, the Federal Government is obligated to provide assistance to the States. As precedent, advocates cite the enactment of Federal air and water quality standards when it became apparent that the States could not deal with environmental problems on an individual basis. Until the Federal administration and the Congress are convinced that, like environmental pollution, cigarette

bootlegging is causing widespread and serious social and economic problems, they are likely to continue to be reluctant to take action.

Federal contraband legislation, however, would provide substantial assistance to the States in their efforts to curtail cigarette bootlegging operations. The enforcement of this legislation most logically would be assigned to the Bureau of Alcohol, Tobacco, and Firearms in the U.S. Department of Treasury. This organization has the type of law enforcement expertise required to deal with the complex nature of cigarette bootlegging. The Bureau has dealt with similar types of problems in their enforcement of the Federal liquor laws and with a considerable degree of success. There are some officials in the Bureau of Alcohol, Tobacco, and Firearms who believe that they could make significant inroads against cigarette bootlegging activities.

#### Law Enforcement Assistance Administration

The Federal Government has assisted the States with grants from the Law Enforcement Assistance Administration (LEAA). A partial listing of these grants follow:

- \$182,436 to North Carolina's Bureau of Intelligence to develop organized crime intelligence (1972).
- \$268,197 to New York State's Department of Taxation and Finance for the purpose of creating an anti-bootlegging cigarette task force (1972).
- \$285,552 to the State of New York's Division of Criminal Justice Services for the purpose of establishing within the New York City Police Department a special investigative unit exclusively devoted to the elimination of organized criminal activities associated with cigarette bootlegging (1972).
- \$787,500 to Indiana to promote cigarette tax law enforcement cooperation among five midwestern States (1975).

#### Interstate Revenue Research Center

The last LEAA grant listed above was used to establish the Interstate Revenue Research

Center (IRRC), which initially included the States of Michigan, Minnesota, Indiana, Illinois, and Ohio. The membership now also includes Florida and Missouri.

The main objective of IRRC is to curtail organized cigarette bootlegging activities in the member States. The bootlegging problem is quite serious in the Midwest, with revenue losses estimated at more than \$100 million in the seven member States. Recent estimates indicate the revenue losses are greatest in Ohio (\$32.5 million), Illinois (\$25 million), Minnesota (\$21 million), and Michigan (\$13.5 million).<sup>2</sup> (ACIR estimates of bootlegging losses in these States are shown in Chapter 7, Table 19.) Indiana, which has the lowest tax rate in the Midwest, appears to be a net beneficiary of cigarette smuggling activity.

IRRC has achieved modest success in curtailing bootlegging activity in the Midwest. About \$300,000 has been returned to member States in the form of tax revenue and monies from the sale of contraband material. The director of IRRC estimates the potential gain to the States at \$4 million per year when the Center is fully effective.

A recent evaluation of the IRRC conducted by the Indiana Criminal Justice Planning Agency reached the following conclusions:

The results presented in the preceding section indicate that to date the Interstate Revenue Research Center has successfully accomplished its intermediate goals. However, there is no indication to any significant degree that its major goal, the overall reduction of the organized smuggling of cigarettes, has been achieved. This assessment is based on project performance data which clearly indicates that the trafficking of untaxed cigarettes is more complex and sophisticated than originally envisioned by the Interstate Revenue Research Center Advisory Board and the subgrantee.

... the very nature of this problem, which arises from differences in State tax rates, makes interstate intelligence gathering and dissemination an essential commodity, which is necessary to counter cigarette smuggling.<sup>3</sup>

The evaluation went on to suggest that an expanded membership and a multi-State intelligence gathering capability would improve the effectiveness of IRRC. The final recommendation of the evaluation was that because of the long-term nature of the problem and the need to develop long-range strategic measures, the grant period should be extended.

This evaluation points up the difficulties the States face in dealing with organized cigarette smuggling and suggests that without Federal contraband legislation, the States cannot expect to significantly reduce the level of bootlegging activity.

#### STATE POLICIES

Half of the States with a smuggling problem are located in the Northeast or Midwest, according to the Battelle-LEAA survey. Of the 45 responses, 24 acknowledged a smuggling problem, 16 indicated no problem, and five were uncertain. Washington was the only State outside the Northeast or Midwest that indicated substantial revenue losses from cigarette smuggling. Several other States indicated moderate revenue losses.

#### State Enforcement Efforts

The pattern of cigarette tax law enforcement is very uneven across the country. Major efforts are made in the Northeast and Midwest, where cigarette smuggling activities are concentrated. Many public officials in the southern States are generally not concerned about bootlegging activities and expend little effort on enforcement. The western States, with the exception of Washington, do not have serious cigarette smuggling problems and, therefore, do not devote much effort to enforcement. (Table 10 presents a classification of States by degree of smuggling problem.)

A number of States have organized formal efforts to combat cigarette bootlegging. One example is IRRC, referred to earlier. Another enforcement group similar to IRRC is the Eastern Seaboard Interstate Cigarette Tax Enforcement Group (ESICTEG), which was created in August 1974 and consists of nine members—Connecticut, Delaware, Maryland, Massachusetts, New Jersey, New York State, New York

City, the Northern Virginia Tax Commission, and Pennsylvania.

This group is engaged in joint surveillance operations, using manpower and equipment provided by its members. Operations are conducted with the cooperation of local authorities in producer States and in the States into which the cigarettes are smuggled. The ESICTEG has

achieved some success—since February 1974, about one million cartons of bootleg cigarettes have been seized—but its efforts have been hampered by its multi-State character. For example, each State has its own radio frequencies and cannot communicate with investigators or enforcement officials from other States.

Although cigarette smugglers are not violating

Table 10  
Classification of States by Degree of Cigarette Tax Evasion Problem in 1975<sup>1</sup>

	Estimated Revenue Gain or (Loss) as Percent of Total Cigarette Collections <sup>2</sup>
<b>Serious Smuggling Problem - 14</b>	
Arkansas	(15.8)
Connecticut	(20.0)
Florida	(17.5)
Illinois	( 9.8)
Massachusetts	( 9.9)
Minnesota	(14.9)
New Jersey	(15.3)
New York	(17.4)
Ohio	( 8.2)
Pennsylvania	(13.6)
Tennessee	(10.1)
Texas	(17.3)
Washington	(18.8)
Wisconsin	(14.2)
<b>Moderate Problem - 9</b>	
Alabama	(10.8)
Arizona	( 9.4)
Georgia	( 3.4)
Maine	(10.3)
Michigan	( 4.3)
Missouri	( 6.1)
Nebraska	( 6.4)
New Mexico	( 6.0)
West Virginia	( 5.8)
<b>Minor or No Problem - 19</b>	
Alaska	( 4.9)
California	( 4.4)
Colorado	0.9
Delaware	( 1.7)
District of Columbia <sup>3</sup>	1.8
Kansas	4.2
Hawaii	NA
Idaho	2.9

(Continued)

the law by purchasing cigarettes in low-tax States, officials in these States often cooperate with high-tax States in combatting cigarette bootlegging. For example, the Rocky Mount, N.C., Police Department has called northern State officials and given them license numbers and descriptions of vehicles that frequent cigarette wholesale firms suspected of selling to

cigarette smugglers. On one occasion, Salisbury, N.C., policemen followed a truckload of cigarettes to New Jersey, enabling New Jersey State Police to arrest the driver and confiscate 10,000 cartons of cigarettes. The reason given for these actions by law enforcement officials in these two cities is that they do not want these "undersirables" in their city. However, law en-

Table 10 (continued)  
Classification of States by Degree of Cigarette Tax Evasion Problem in 1975<sup>1</sup>

	Estimated Revenue Gain or (Loss) as Percent of Total Cigarette Collections <sup>2</sup>
<b>Minor or No Problem (continued)</b>	
Iowa	( 7.1)
Louisiana	( 3.4)
Maryland	0.3
Mississippi	( 3.6)
Montana	( 2.7)
Nevada	3.0
North Dakota	( 1.9)
Oklahoma	( 2.7)
Rhode Island	( 1.7)
South Dakota	( 1.0)
Utah	3.2
<b>Beneficiaries of Tax Evasion in Other States - 9</b>	
Indiana	6.8
Kentucky	34.9
New Hampshire	46.7
North Carolina	33.9
Oregon	5.1
South Carolina	4.3
Vermont	11.0
Virginia	5.1
Wyoming	4.5

<sup>1</sup>States are classified on percentage gain or loss of revenue and the following factors:

1. Battelle-LEAA survey of State perceptions of magnitude and type of bootlegging problems.
2. Per capita cigarette sales relative to the U.S. average.
3. State tax rate relative to tax rates in bordering States.
4. State tax rate relative to tax rates in low-tax States.
5. Analysis of variables affecting cigarette sales in the States.

<sup>2</sup>Dollar gain or loss shown in Table 19 (Chapter 7).

<sup>3</sup>Recent tax rate increases have resulted in large sales losses. Based on current data and rates in Maryland and Virginia, Washington, D.C., probably could be classified in the serious category.

Source: ACIR staff compilation; see Appendix B.

forcement officials in some southern cities do not make any attempt to cooperate with northern State officials. One North Carolina police chief indicated that he did not interfere because he would be committing a disservice to legal businessmen—interference would damage their business.<sup>4</sup>

Auditing is an important aspect of cigarette tax law enforcement that is sometimes overlooked. The National Tobacco Tax Association's (NTTA) Committee on Tax Evasion report identified the important role of the auditor:

A vigorous audit program leads to the downfall of the crooked dealer and is a certain deterrent to the dealer who is toying with the idea of cheating. The manufacturer's print out of sales to stamping agents and others authorized to receive unstamped cigarettes is one of the most useful tools in the auditor's briefcase. While audit procedures vary greatly within NTTA States, the time-tested sales audits of stampers who stamp for foreign States, and the inventory check of stamps and meter units paid for by the dealer against his sales, is the rock on which strong audit programs are built.

Returns from responding States show continued rises in revenue from States which rely solely on audit programs. This certainly does not proclaim that auditing is the only way to run a tax collection program any more than the utilization of investigators only is ideal . . . but it does indicate that auditing, conducted on a sophisticated and vigorous basis, works.<sup>5</sup>

These enforcement efforts have achieved some success. The NTTA's Committee on Tax Evasion conducted a State survey on cigarette smuggling for the period from July 1, 1975 to June 30, 1976. Some findings from that survey are summarized:

- There were 1,545 criminal cases and 499 civil cases involving cigarette smuggling during the period surveyed.

- The total number of persons arrested in the 12 States that reported such arrests was 1,696.

- Twenty-one States reported seizing 286,422 cartons, eight States reported seizing 70 vehicles, and five States reported seizing 181 vending machines. In addition, one counterfeiting device was seized.

- Total fines levied were \$201,200 and total days of jail terms imposed was 7,555.

The available information indicates that although cigarette smuggling exists to some degree in about half of the 50 States, only about a dozen States are concerned enough to allocate more than a token amount to cigarette tax law enforcement activities. There is little reliable data on the amount of money States spend on enforcing cigarette tax laws, but the available data indicate that even those States acknowledging serious smuggling problems are not willing to spend large amounts of money on this type of law enforcement. The reason is that some State officials and legislators do not place a high priority on this problem, often because the problem is not recognized. However, even where a problem is documented, it is difficult to convince decisionmakers that additional expenditures for law enforcement are a wise investment. State governments have pressing needs in many areas, and tax administration has tough competition for limited State resources. A case can be made that State legislatures are not devoting sufficient resources to enforcement of cigarette tax laws, but given political and budgetary realities, it is unlikely that the States will be willing to allocate the resources needed to reduce cigarette smuggling to a tolerable level.

This statement does not mean that tax administrators and law enforcement officials responsible for enforcing the cigarette tax laws are not making a substantial effort to stop bootlegging. However, given the limited resources they have to work with and the difficult nature of the problem, it is questionable whether they can be much more effective without greater support from all branches of State government and additional Federal assistance.

## State Cigarette Tax Laws

State laws prohibiting cigarette smuggling bears little similarity in the jurisdictions and powers of the agencies charged with enforcing these prohibitions. Despite this variance, there are some common statutory patterns that can be seen in most State cigarette tax legislation.

Smuggling cigarettes is illegal in almost every State. In most States, it is a crime, punishable by fine and/or imprisonment, to possess, transport, deliver, or sell improperly stamped cigarettes.

The penalties range from a fine of a few hundred dollars in Massachusetts, Idaho, and New Mexico to fines of several thousand dollars and imprisonment for several years in Texas, Pennsylvania, and New York. States that place cigarette tax violations at the misdemeanor level tend to punish possession, sale, and delivery of unstamped cigarettes in a similar manner. Jurisdictions that place cigarette smuggling at the felony level usually attach misdemeanor penalties for possession or sale of unstamped cigarettes where intent to defraud cannot be proved and felony penalties where intent can be proved.

Many States that treat cigarette smuggling as a felony also differentiate between first and repeat offenders. For example, in Nevada, the first offense is a misdemeanor, but subsequent offenses are felonies punishable by a fine of up to \$5,000 and/or imprisonment of up to 10 years.

Although States are not uniform in their treatment of sellers, transporters, and possessors of unstamped or unlawfully taxed cigarettes, a great degree of uniformity exists in the treatment of persons who counterfeit or alter tax stamps. Such offenders are often punished as felons and almost always punished more severely than other cigarette tax violators. For example, in Texas, counterfeiters can receive a prison sentence of up to 20 years. In Pennsylvania, Arizona, Kentucky, and Wisconsin, the maximum penalty is 10 years imprisonment; in most States, the maximum penalty for this crime is 5 years imprisonment. In several States—for example, South Carolina, New Mexico, and Nevada—the penalty for counterfeiting is relatively minor.

The penalties for cigarette smuggling activi-

ties are not very heavy. (See Table 11.) Most States classify violations as misdemeanors. Only nine States classify any violation as a felony. Very few States impose punishment that could be considered a real deterrent to violators. The responses to the Battelle-LEAA survey indicated that only six States imposed jail penalties for cigarette smuggling in the 1-year period covered by the questionnaire and that the sentences were generally light.

In addition to criminal penalties, a number of States have statutory provisions for the confiscation of illegal cigarettes and motor vehicles used to smuggle cigarettes.

As might be expected, the penalties in low-tax States generally are unusually light. For example, in South Carolina, the only violation is possession of untaxed cigarettes and the only penalty is a \$20 to \$100 fine. In Indiana, possession is also the only violation and the penalty is imprisonment of 10 to 90 days and a fine of \$100 to \$1,000. These States have no need for heavy penalties because they do not have bootlegging problems. However, even the high-tax States with serious bootlegging problems do not levy, in most cases, substantial penalties on violators of cigarette tax laws.

The lack of strong, uniform State laws against cigarette smuggling is a serious handicap to law enforcement officials. IRRC has recognized this problem and is attempting to encourage member States to strengthen their State statutes. In recent years, several States have strengthened their laws and increased the penalties for cigarette smuggling.

NTTA supported tougher State laws in the *Report of the Committee on Tax Evasion*:

... conviction with a jail sentence is the best deterrent to curtail the illegal operations. Violators can "live with" probation and a small fine, but cannot afford a heavy fine and confinement.

In rendering sentences in cases, judges have been somewhat lenient and, as a result, it gives the opportunity to these violators to be "back on the street" operating as they did in the past as it is the only type of work they know and it is easy money. It should be strongly recommended by the Attorney General's office to seek heavier sen-

**Table 11**  
**Summary of State Cigarette Tax Penalties for Illegal Possession or Transportation of Untaxed Cigarettes**

	Violation					Violation Class		Criminal Penalty				
	Transportation of Untaxed Cigarettes	Transportation Without Permit	Transportation Without Invoices, etc.	Possession	Possession With Intent to Sell	Other	Misdemeanor	Felony	Light	Moderate	Heavy	Increased Penalty For Second Offense
Alabama	x			x			x		x			
Alaska				x			x		x			
Arizona						x	x		x			
Arkansas				x			x		x			
California			x			x	x			x		
Colorado					x		x		x			
Connecticut	x		x	x	x	x			x		a	x
Delaware			x	x			x		x			
Florida					x		x	b	x			x
Georgia			x	x		x	x		x			
Hawaii						x			x			
Idaho	x			x			x		x			
Illinois		x				x	x	c	x			
Indiana				x			x		x			
Iowa					x		x		x			
Kansas				x			x		x			
Kentucky	x	x		x					x			
Louisiana		x					x		x			
Maine				x	x	x			x			
Maryland			x	x			x	d	x			
Massachusetts			x	x	x	x			x			
Michigan	x	x	x	x		x		e	x	x		
Minnesota	x				x		x		x			
Mississippi				x			x		x			
Missouri					x		x		x			
Montana	x						x		x			
Nebraska						x				x		
Nevada						x				x		
New Hampshire		x			x	x	x	f	x			x
New Jersey		x	x	x		x	x		x			x





tences (fines and custodials) against violators as it is the only means of curtailing their illicit operations. The violator must be hurt in his "pocket book" if it is to have any impact. Major violators are not prone to rehire drivers or peddlers who are "lossers," (sic) i.e., having been arrested.<sup>6</sup>

The New York State Special Task Force on Cigarette Bootlegging has recommended that criminal penalty provisions be transferred from tax law to penal law. Enforcement agents and prosecutors have stated that this change would result in a substantive improvement in cigarette tax compliance and judicial enforcement of cigarette tax laws.

A more concerted effort in this area will be helpful in the States' effort to combat cigarette smuggling activities. However, the general view among State law enforcement officials is that the States will never be able to enforce effectively cigarette tax laws without Federal assistance. But until the States strengthen their own laws, they will be open to criticism that they have not made sufficient effort to stop cigarette smuggling and the case for Federal contraband legislation will be weakened.

#### Tax-Free Purchase of Cigarettes

Based on a comparison of Federal and State cigarette tax collections between fiscal years 1970 and 1975, an average of 1.74 billion packs of cigarettes or 6.2 percent of total U.S. cigarette sales were exempt from State and local taxation. Of this amount, nearly two-thirds was due to the exemption of sales at military bases and the majority of the remainder to sales at Indian reservations.

#### Indian Reservations

Five western States consider the purchase of tax-free cigarettes on reservations by non-Indians as a major tax evasion problem.<sup>7</sup> The problem appears to be particularly severe in Washington State. The Washington Department of Revenue estimated the revenue loss at \$0.7 million in 1969 and at over \$10 million in 1975. A case was cited of one Indian smoke shop owner who sold 932,283 cartons of cigarettes in a 1-year period, realizing a gross income of over

\$1,000,000. The State of Washington's loss on these cigarettes was \$1,687,000.

Court decisions have limited State taxing on Indian reservations. The decisions are based largely on 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; . . ."

In recent years, the U.S. Supreme Court has rendered several decisions on the States' powers to tax reservation Indians. In 1973, the Court, in *McClanahan vs. Arizona Tax Commission*, held that the Arizona income tax does not apply to Indians employed on a reservation.

In *Mescalero Apache Tribe vs. Jones*, the Supreme Court in 1973 upheld the New Mexico sales tax on ski lift tickets at a resort operated by reservation Indians but not located on reservation land. In this decision, the Court applied the principle that unless Federal law expressly prohibits the taxation of Indians beyond reservation boundaries, they are subject to all nondiscriminatory laws applicable to citizens of the State.

Several recent cases are more directly relevant to the State cigarette tax evasion problem. In *Moe vs. Confederated Salish and Kootenai Tribes*, decided by the Supreme Court in 1976, the major issue was the right of Montana to impose a tax on cigarettes sold to Indian residents of the reservation. The Court held that the cigarette tax could not be imposed on reservation purchases by an Indian resident, but because the cigarette tax is paid by the consumer or user, the tax could be imposed on the sales to non-Indians. More recently, the U.S. Supreme Court, in *Bryon vs. Itasca County, Minnesota*, overturned a Minnesota Supreme Court ruling that extended all nonrestricted tax laws of the State to Indian reservations.

The State of Minnesota has handled its problem with Indian cigarette sales by precollecting the tax on cigarettes sold on Indian reservations and refunding the tax to the Indians on the basis of average State per capita consumption times the population of the reservation.

In South Dakota, the problem was solved by the State and the Indian tribes passing legislation to enable the State Department of Revenue to precollect the tax on cigarettes sold to

Indians on the reservation. The Indian tribes in South Dakota impose a tax on cigarettes at the same rate as the State and have authorized the State Commissioner of Revenue to collect these taxes on reservation sales. In turn, South Dakota passed enabling legislation to permit the Commissioner of Revenue to collect the cigarette taxes on behalf of the Indians.

As it is unlikely that State taxing powers will be extended to the Indian reservations, the solution to this cigarette tax evasion problem appears to be a cooperative effort between the Indians and the State, as has occurred in Minnesota and South Dakota. The major barrier to a cooperative effort is the loss of cigarette sales by Indian smoke shops if they levied the State cigarette tax. To overcome this problem, States could provide the Indians a certain portion of the cigarette tax as compensation for lost sales in addition to the refund for the tax paid by reservation Indians.

#### Military Sales

The purchase of tax-free cigarettes from military commissaries and exchanges for non-military persons generally is not done on an organized basis but can represent a significant revenue loss to the States. This Commission concluded in a recent report:

The higher per capita sales figures for military store patrons . . . 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.<sup>8</sup>

On the basis of the evidence of tax evasion resulting from military store sales, the Commission recommended that "the current exemption of on-base sales to military personnel from State and local taxation should be removed."<sup>9</sup> The implementation of this recommendation will end this particular problem.

The revenue losses attributable to military store sales exceed 10 percent of total cigarette tax collections in five States—Alaska, Hawaii, New Mexico, South Carolina, and Washington. The largest percentage losses are 27.4 percent in Alaska and 28 percent in Hawaii—States with a large military population relative to total population. (See Appendix Table A-6.)

The extension of State and local sales taxes to all military sales will probably not be achieved in the near future. Meanwhile, a strong case can be made that, at a minimum, State and local cigarette taxes and sales taxes on cigarettes should be extended to military sales.

#### FOOTNOTES

<sup>1</sup>Memorandum to Rep. Peter W. Rodino from W. Vincent Rakestraw, U.S. Assistant Attorney General, dated April 1974.

<sup>2</sup>Indiana Criminal Justice Planning Agency, *Evaluation of the Interstate Revenue Research Center* (Indianapolis, Ind.: undated) conducted by Donald E. Balner, pp. 6-10.

<sup>3</sup>*Ibid.*, pp. 16-17.

<sup>4</sup>*The News and Observer*, Raleigh, N.C., July 14, 1974.

<sup>5</sup>National Tobacco Tax Association, *Report of the Committee on Cigarette Tax Evasion* (Chicago, Ill.: September 1976) p. 5.

<sup>6</sup>National Tobacco Tax Association, *Report of the Committee on Cigarette Tax Evasion* (Chicago, Ill.: September 1975) p. 3.

<sup>7</sup>Idaho, Montana, Nevada, New Mexico, and Washington.

<sup>8</sup>ACIR, *State Taxation of Military Income and State Sales* (Washington, D.C.: Government Printing Office, July 1976) p. 18.

<sup>9</sup>*Ibid.*, p. 3.

## Chapter 5

## The Quest for More Uniform Rates

Cigarette tax differentials have been recognized as the major cause of cigarette bootlegging. Likewise, uniformity of tax rates is recognized as the most effective treatment of this problem. However, Federal incentive programs would be needed to encourage the pursuit of uniform tax rates. For example, the need for more uniform rates to offset tax differentials has been recognized in a recent report by the New York State Special Task Force on Cigarette Bootlegging, which recommended that New York City repeal its 8 cent cigarette tax rate and New York State lower its rate from 15 to 13 cents.<sup>1</sup> The State and city would lose revenue, but a large part of the loss would be offset by a reduced level of bootlegging. There is optimism in the tobacco industry that this recommendation can be implemented, but it is questionable whether the State and City of New York will lower their rates without Federal reimbursement.

This chapter discusses several optional approaches for Federal action to create incentives for the States to reduce their tax differentials.

### HISTORY OF FEDERAL INCENTIVE PROPOSALS

In the past, several proposals have been advanced to encourage the States or the Federal

Government to withdraw from the cigarette tax field. Few proposals have been advanced to encourage uniform State cigarette tax rates.

The first withdrawal proposal to receive attention was the Edmonds-Graves plan, which was advanced in the early 1930s. This plan would have distributed one-sixth of Federal cigarette tax revenues among the States in proportion to their population on the condition that the States withdraw from the cigarette tax field. About the same time, Congressman Doughton of North Carolina, Chairman of the House Committee on Ways and Means, introduced a resolution calling for the sharing of Federal cigarette tax revenues with the States along the lines of the Edmonds-Graves plan.

These early proposals were motivated by the belief that State taxation of cigarettes would reduce consumption and impair Federal revenues. The Interstate Commission on Conflicting Taxes analyzed the Doughton resolution and concluded that no additional tobacco taxes should be imposed by the States for revenue gathering purposes.

The next proposal on this subject was advanced in the early 1940s by a special committee appointed by the Secretary of the Treasury to conduct a study on intergovernmental relations. This special committee endorsed the Edmonds-Graves and Doughton proposals and recommended exclusive Federal

taxation of cigarettes with the States sharing in the revenue.

The Treasury study recommended that the Federal tax on cigarettes be increased by 2 cents per pack and that this revenue be distributed to the States on a per capita basis. The distribution would be conditional upon State and municipal withdrawal from the field. The recommendations were never considered by Congress.

In 1947, a Joint Committee of the American Bar Association, The National Tax Association, and the National Association of Tax Administrators issued a report expressing support of the States abandoning tobacco taxes for exclusive Federal use. The report concluded:

Tobacco taxation was developed by the Federal government for substantial revenues before the State came into the field. The Federal government has administrative advantages and can exploit this revenue more effectively, as a rule, than the States. As evidence of the earnest desire of the States to promote tax coordination, it is recommended by the Joint Committee that the States forego this revenue for the benefit of the Federal government. However, if this arrangement is not found to be feasible, the States should be free to tax tobacco in order to raise independent revenue. In this event it will be desirable to increase the cooperation of the governments taxing tobacco for their mutual advantage and the benefit of the taxpayers who desire more convenient and equitable taxation.<sup>2</sup>

In the late 1940s, the pendulum began to swing away from proposals for State abandonment of cigarette taxes and toward Federal abandonment. In 1947, an informal group made up of Governors and members of Congress issued a statement proposing that the Federal Government limit its use of certain taxes adapted to State and local use and that State and local governments reciprocate. Tobacco taxes were not mentioned specifically. In 1948, the Council of State Governments recommended that the Federal Government limit its

taxes on liquor and tobacco so that these sources could be used for the support of State governments.

In 1953, the House Ways and Means Committee's Subcommittee on Federal, State, and Local Taxes issued a report that commented on the 1942 recommendation that States withdraw from the cigarette tax field as follows:

Since the formulation of this latter recommendation, State taxation of tobacco has become more widespread and varied and the problems of coordination more difficult. In 1942, State sharing in Federal revenues would have left most of the States at least as well off as they were on the basis of their own imposed tax. That situation no longer prevails since many States have taxes in excess of 2 cents. The wide variations in the level of State rates adds to the complexity of the problem.<sup>3</sup>

In 1954, the National Tax Association's Committee on Intergovernmental Fiscal Relations rejected State withdrawal from the cigarette tax field, and in 1956 the president of the Association voiced acceptance of State-Federal overlapping in cigarette taxation and stated that this overlapping was probably permanent. From that point on, attempts to encourage State or Federal withdrawal from the field appear to have been abandoned.

Attention began to focus in the late 1950s on another approach to coordination, one that would leave the States free to set their own tax rates but would strengthen their administration by providing for the collection of the State taxes from the manufacturer rather than from the distributor. Despite a 1964 ACIR recommendation supporting this approach, the collection of taxes by the manufacturer has generated little support among tobacco administrators or tobacco manufacturers. (For further discussion of this issue, see Chapter 6 of this report.)

To encourage Federal-State coordination of cigarette taxes and more uniform cigarette tax rates, Senator Smathers of Florida introduced a resolution several years ago calling for the sharing of Federal liquor and tobacco tax revenues. This proposal imposed no specific re-

quirements on the Federal or State governments in respect to tax rates.

In a report at a 1972 meeting of the National Tobacco Tax Association, Rep. Ralph Turlington of Florida presented a plan for achieving more uniform cigarette tax rates. Under his proposal, the Federal cigarette tax would be increased from 8 cents to 18 cents per pack and the additional revenue would be returned to the States provided the total Federal and State tax did not exceed 27 cents per pack; the States would receive the 11 cent rebate as long their tax rate did not exceed 8 cents. The State collection agency would issue a receipt to the wholesaler for the 11 cents per pack, which in turn would be given to the manufacturer, who would use it as a credit toward the amount due to the Federal Government.

Had the States been encouraged to withdraw from the cigarette tax field before the cigarette tax became an important State revenue source, cigarette smuggling would not be the problem it is today. Now, it is probably unrealistic to expect the States to abandon the field completely nor is it clear that this step is desirable. Nonetheless, there does appear to be sufficient justification to encourage the States to reduce the differential in cigarette tax rates. Although cigarette smuggling activities can be curtailed by improved Federal and State law enforcement efforts, it is unlikely that full resolution of the problem can be achieved without a reduction in the variance of State cigarette tax rates.

### UNIFORM TAX OPTIONS

There are a number of different options that could be used to achieve uniform State tax rates. The most extreme method would be to repeal the State's authority to levy cigarette taxes. The Federal Government would levy a uniform rate, collect all taxes, and return revenues to the States on a formula basis. A modification of this approach would raise the Federal excise tax to, for example, 20 cents and rebate 12 cents to all States who repealed their cigarette tax or kept it at a low level.

These options have the major disadvantage of interfering with the States' taxing authority. Although they would completely eliminate all major cigarette bootlegging, they would result

in a loss of State autonomy, which could be too great a price to pay, particularly for the vast majority of States not subject to substantial cigarette smuggling activities.

Despite its coercive nature, a plan whereby the Federal Government raises Federal cigarette tax rates to 20 cents and rebates 12 cents to each State that sets its tax rate (including local taxes) at no higher than 3 cents for example, does have some merit. Such a plan would virtually end organized cigarette smuggling by largely eliminating State tax differentials.

This plan is so coercive that every State would almost certainly be forced to participate. The States that might be reluctant are the high-tax States because of a concern about the loss of revenue. However, the 12 cent rebate plus the 3 cent State tax option and the increase in sales due to reduced bootlegging would offset the repeal of the State tax in every State but Connecticut, Florida, Maine, New Jersey, New Hampshire, and Texas, which would lose revenue because of their high consumption and relatively high tax rates.

The low-tax and high-sales States would, of course, receive a windfall from this plan. One way to reduce the windfall to some States and to compensate the losers would be to put a percentage cap on how much a State could receive in excess of its actual collections, with the excess revenue used to compensate States that lose revenue. For example, North Carolina would gain about \$67 million from the plan (without the 3 cent option). If a 50 percent cap were placed on distribution, they would gain only about \$10 million and \$57 million would be available for distribution to other States or for some other purpose. This windfall could also be limited by reimbursing only as many cents as the State tax rate up to a maximum of 12 cents.

Estimates of the revenue effect of this plan on the States and the District of Columbia are shown in Table 12. The calculations are based on the assumption that every State would levy the 3 cent optional tax, although that might not be the case in States that receive a large revenue gain from this plan, such as California, North Carolina, and Virginia. The sales figures used to calculate the revenue from the 3 cent tax are ACIR estimates of States' sales assum-

ing uniform tax rates. (See Appendix B.) The estimates would, of course, change with changes in tax rates and per capita sales.

The distribution of revenue to the States would be based on population. This formula would be the easiest to administer, although it would discriminate against States with high per capita sales and favor States with low per capita sales. The most equitable formula would be one based on cigarette sales without bootlegging. If this plan worked as expected, these sales figures would be available in all States except those that chose not to levy a State ciga-

rette tax. Developing sales figures for these States would create some administrative difficulties. If current consumption figures were used, the high-sales States would receive an even larger windfall. Population may not be the best basis for revenue distribution, but it does serve for illustrative purposes.

The tobacco industry should not find this plan objectionable, because the average nationwide tax rate would be almost unchanged from the current 21 cent level and total U.S. consumption would not be adversely affected.

An approach that would be more feasible

Table 12  
Estimated Revenue Disbursements to the  
States Under Federal Tax Credit Proposal  
(Based on 1975 Data)

State	1 Current Net Collection (in millions)	2 Proposed Shared Revenue (in millions)	3 Optional 3 Cent State Tax Revenue <sup>1</sup> (in millions)	4 Total Revenue (2 + 3) (in millions)	5 Net Gain or (Loss) (4 - 1) (in millions)
Alabama	\$ 44.7	\$ 58.2	\$14.2	\$ 72.4	\$ 27.7
Alaska	4.0	5.7	1.4	7.1	3.1
Arizona	33.7	31.9	8.1	40.0	6.3
Arkansas	40.4	34.2	8.4	42.6	2.2
California	263.4	339.9	86.6	426.5	163.1
Colorado	31.4	40.7	9.9	50.6	19.2
Connecticut	70.7	49.9	14.0	63.9	(6.8)
Delaware	11.6	9.6	2.5	12.1	0.5
District of Columbia	7.3	11.6	3.6	15.2	7.9
Florida	178.0	134.4	38.4	172.8	(5.2)
Georgia	69.9	79.3	19.7	99.0	29.1
Hawaii	7.8	14.0	2.3 <sup>2</sup>	16.3	8.5
Idaho	8.5	13.3	2.9	16.2	7.7
Illinois	172.8	179.2	49.2	228.4	55.6
Indiana	49.9	85.5	21.9	107.4	57.5
Iowa	43.5	46.2	12.2	58.4	14.9
Kansas	29.9	36.6	9.1	45.7	15.8
Kentucky	21.2	54.7	13.6	68.3	47.1
Louisiana	52.0	61.2	14.5	75.7	23.7
Maine	23.0	17.1	4.3	21.4	(1.6)
Maryland	36.5	66.0	17.8	83.8	47.3
Massachusetts	115.1	93.7	25.8	119.5	4.4
Michigan	135.6	147.4	38.4	185.8	50.2
Minnesota	76.6	63.2	16.5	79.7	3.1
Mississippi	27.5	38.0	8.6	46.6	19.1
Missouri	56.5	76.6	20.3	96.9	40.4
Montana	10.6	12.3	2.8	15.1	4.5
Nebraska	21.7	25.0	6.1	31.1	9.4
Nevada	11.2	9.6	3.5	13.1	1.9
New Hampshire	23.0	13.3	3.4	16.7	(6.3)

would be to encourage the States to agree on a narrower range of cigarette tax rates than currently exists, which would eliminate a substantial portion of organized bootlegging activity. Because it is unlikely that the States will agree on such a range voluntarily, the most reasonable alternative might be the adoption of a Federal tax credit program that encourages low-tax States to raise their rates and high-tax States to lower their rates.

The vast majority of States levy a rate between 8 and 15 cents. If all States could be encouraged to set their rates within this range,

the incentive for bootlegging would be substantially reduced. The problem of casual smuggling across borders would still exist in a few States, but organized criminal activities would be largely eliminated and revenue losses of high-tax States would be sharply cut. (Casual bootlegging on a large scale would probably exist only where rates in bordering States differed by more than 2 or 3 cents.)

The major stumbling blocks to more uniform tax rates are twofold. First, the high-tax States are not willing to lower their rates because of expected revenue loss. Second, the low-tax

Table 12 (continued)  
Estimated Revenue Disbursements to the  
States Under Federal Tax Credit Proposal  
(Based on 1975 Data)

(State continued)	Current Net Collection (in millions)	Proposed Shared Revenue (in millions)	Optional 3 Cent State Tax Revenue <sup>1</sup> (in millions)	Total Revenue (2 + 3) (in millions)	Net Gain or (Loss) (4 - 1) (in millions)
New Jersey	167.8	117.6	32.7	150.3	(17.5)
New Mexico	13.4	18.5	3.8	22.3	8.9
New York	332.5	291.4	82.1	373.5	41.0
North Carolina	20.7	37.9	22.1	110.0	89.3
North Dakota	8.0	10.3	2.4	12.7	4.7
Ohio	191.2	173.1	45.4	218.5	27.3
Oklahoma	44.9	43.8	10.3	54.1	9.2
Oregon	30.9	36.9	9.0	45.9	15.0
Pennsylvania	239.6	190.2	52.1	242.3	2.7
Rhode Island	19.0	15.1	4.1	19.2	0.2
South Carolina	20.7	45.5	10.9	56.4	35.7
South Dakota	8.9	11.3	2.5	13.8	4.9
Tennessee	61.6	67.4	17.2	84.6	23.0
Texas	249.9	197.0	49.9	246.9	(3.0)
Utah	6.8	19.5	2.6	22.1	15.3
Vermont	8.5	7.9	2.0	9.9	1.4
Virginia	16.8	80.8	21.2	101.2	84.4
Washington	54.7	57.1	14.0	71.1	16.4
West Virginia	24.4	29.1	7.5	36.6	12.2
Wisconsin	81.0	74.2	19.2	93.4	12.4
Wyoming	4.3	6.2	1.5	7.7	3.4
<b>TOTAL</b>	<b>\$3,283.6</b>	<b>\$3,428.3</b>	<b>\$892.5</b>	<b>\$4,320.8</b>	<b>\$1,037.2</b>

<sup>1</sup>The 3 cent tax was applied to hypothetical sales figures assuming that a uniform tax is imposed.

<sup>2</sup>Hypothetical sales estimates were not computed; actual sales figures were employed.

Source: Computed by the ACIR staff; see Appendix B.

States are reluctant to raise their rates because of the tobacco industry's opposition to higher cigarettes taxes. The low-tax States could also be concerned about a possible reduction in revenue if they lose their tax advantage.

These obstacles can be overcome if the Federal Government provides payments to those States that move their rates closer to or within a specified range. The payments would be financed by an increase in the Federal cigarette tax. For example, a high-tax State that lowers its rate 1 cent per pack might receive reimbursement equal to 1 cent times the State's cigarette sales. A low-tax State that raises its rate 1 cent might also receive reimbursement equal to 1 cent times sales. In the case of the high-tax State, the reimbursement would offset the revenue loss resulting from a lower rate; the loss could be more than offset if sales in the State increased because of a decline in smuggling activities. The low-tax States could use the Federal reimbursement to offset revenue lost because of decreased bootlegging activities and/or to reduce other taxes in the State. States in the desired tax range could also be provided tax rebates to offset the higher Federal levy.

#### Criteria for Federal Tax Credit Proposal

No matter what type of approach is adopted, there are several criteria that must be considered in the design of a Federal incentive program. These are:

**Parity.** The incentive system should provide relatively equal treatment for all States. The high- and low-tax States, whose taxing policies have helped create the bootlegging problem, should not receive greater Federal aid than the moderate-tax States, who have largely avoided serious bootlegging problems. Thirty-one States currently have a tax rate between 8 and 13 cents. Of these States, only three or four have what could be classified as a significant cigarette smuggling problem and, in each case, the State borders a low-tax State.

**Flexibility.** A Federal incentive system must be strong enough to provide the States "an offer they cannot refuse," but it should not be so coercive as to seriously limit State tax prerogatives. The system should allow the States a fair-

ly broad range in which to make their tax decisions. However, if the range is too great, the goal of achieving the uniformity needed to curtail smuggling activities will be compromised.

**Transition.** The incentive system should be implemented in a manner that will allow the States time to adjust to the new rules and to minimize the shock of a large tax increase. A problem that has existed for a decade cannot be eliminated overnight. If the program is phased in over a few years, the States will have time to respond to the incentives in an orderly fashion and the cigarette consumer will not be subjected to a large, sudden increase in cigarette taxes.

#### THE CIGARETTE TAX AS A REVENUE SOURCE

Although the concept of State autonomy is hard to argue with in principle, one may make a convincing case for establishing the cigarette tax as an exception to the principle on practical grounds. First, the high value, low breakage, and small size of the product make it highly conducive to smuggling when tax differentials exist. Thus, a State may create a profit incentive for organized crime that is costly to other States by raising or lowering its tax only a few cents. Second, the high concentration of the tobacco industry in three States provides these States with a good reason for keeping their cigarette taxes at a minimum. During periods of inflation, the stable rates in these States result in a reduction of the "real" tax rate. This accentuates rate differentials with other States that may be raising their cigarette tax rate to ease fiscal difficulties.

Whenever a State is in fiscal difficulty, cigarette tax increases are attractive because of the marginal additions to revenue they can provide. The result of a succession of such marginal tax increases is, of course, a high cigarette tax. Meanwhile the low-tax State has a strong incentive to keep the tax constant. Because the costs of the resulting bootlegging are, to a large extent, born by the Nation as a whole in the form of increased organized criminal activity, there is little reason for a given State to unilaterally reduce (a high-tax State) or increase (a

low-tax State) its tax. Unless some Federal incentive is supplied for more uniform rates, all States will be forced to pay for the excesses of the high- or low-tax States.

A further reason for the Federal Government to establish limits to State cigarette taxing authority (as an exceptional case) concerns Federal interest in health and income distribution as they relate to the cigarette tax in particular. The high tax on cigarettes, similar to the liquor tax, has been justified by the value judgement that people should be penalized for consuming a product that is dangerous to their health. It can be argued, however, that such a judgement should be made on a national level and uniformity should be the rule regarding the level of such a tax.

The Federal Government has offered little leadership in this respect and has allowed the States individually to make the decision. The States appear to have ignored this role, because the present pattern of cigarette taxes reflects, to a greater extent, revenue conditions rather than health-conscious value judgements. High taxes are found in the Northeast and the Midwest and lower taxes are found in the South and West. This pattern is in direct conflict with the expected disapproval of smoking, which if reflected in consumption patterns, should be highest in the West and South and lower in the Northeast and Midwest. (See Chapter 7, Table 18.)

The Federal Government also has interests in the distributional effects of taxes, and the extremely high regressivity of the cigarette tax makes it subject to Federal concern. A 1970 study indicated that the Federal cigarette tax (8 cents a pack) was the most regressive of all Federal excise taxes.<sup>4</sup> The tax rate in most States has far surpassed the Federal levy, with the result that the combined State and Federal cigarette tax has a highly regressive impact on income distribution.

It has been argued further that the regressivity issue should be considered along with the health effect of cigarettes at the Federal level in order to achieve a consistent policy. The solution to bootlegging need not be inconsistent with the normative value judgement on health and income distribution. If the Federal Government decides that the health impact is most important, then a uniformly high tax

credit scheme would be indicated. If it is decided that the tax has little effect on cigarette consumption and, thus, on health, then a uniformly low tax may be agreed upon. In any event, the cigarette tax does appear unique in its impact on Federal matters, and Federal intervention may be required, even with the enactment of Federal contraband legislation.

#### A PROPOSED FEDERAL INCENTIVE PLAN

A tax incentive proposal that would meet all criteria listed above and provide a strong incentive for uniform tax rates is outlined below.

This incentive program would be financed by a phased increase in the Federal excise tax on cigarettes (currently 8 cents). In the first year, the tax would be increased 2 cents, and in each subsequent year, a 1 cent increase would be imposed until a cumulative increase of 6 cents is reached in Year 5. These funds would be used to provide Federal rebates to the States based on cigarette consumption. The program would take the form indicated in Figure 1.

This plan is intended to encourage all States to adopt a cigarette tax in the range of 8 to 15 cents by the end of 5 years. One possible problem is that States would wait until the last year to take action, particularly in the case of low-tax States. High-tax States would be under pressure to lower their rate to offset the higher Federal tax rate. Low-tax States would be subjected to a higher Federal tax and might be reluctant to raise their own rate, even though they would lose Federal money each year they delayed.

The maximum rebate of 6 cents is intended to encourage the lowest taxing State—North Carolina at 2 cents—to raise its rate to 8 cents and the highest taxing States—Massachusetts and Connecticut at 21 cents—to lower their rates to 15 cents. The 5-year time period could be shortened or lengthened depending on the actions taken by the States.

A maximum rebate is also used to limit the cost in any one year and to prevent low- and high-tax States from receiving larger rebates than moderate-tax States. The maximum rate is



not cumulative and in no case could the total rebate exceed 6 cents in any one year.

The rebate allowed for low-tax States is less generous than for high-tax States because low-tax States will be receiving double benefits from the increase in their tax rate and the Federal rebate. The only losses the low-tax States might incur would be due to a reduction in the purchase of bootleg cigarettes as the tax differentials are reduced. The high-tax States will, of course, suffer revenue losses as they lower

their tax rates and must be compensated for these losses. However, a one-for-one rebate may not be required because as bootlegging is reduced, consumption will rise in the high-tax States.

The rebates granted to the States would be permanent under this proposal, but an alternative would be to phase the rebates down gradually or out completely. This would, of course, allow the increase in the Federal excise tax to be phased out as well. However, some in-

**Figure 1**  
**Schedule for Federal Incentive Plan**

	State Cigarette Tax Rate	Federal Rebate
Year 1 (10 cent Federal tax)	2-7 cents	1 cent rebate for each 2 cent increase in State tax rate
	8-15 cents	2 cent rebate
	16 cents +	1 cent rebate for each 1 cent decrease in State tax rate
	Maximum rebate - 2 cents	
Year 2	2-7 cents	1 cent rebate for each 2 cent increase in State tax rate
	8-15 cents	3 cent rebate
	16 cents +	1 cent rebate for each 1 cent decrease in State tax rate
	Maximum reb. 3 - 3 cents	
Year 3	2-7 cents	1 cent rebate for each 2 cents increase in State tax rate
	8-15 cents	4 cent rebate
	16 cents +	1 cent rebate for each 1 cent decrease in State tax rate
	Maximum rebate - 4 cents	
Year 4	2-7 cents	1 cent rebate for each 2 cents increase in State tax rate
	8-15 cents	5 cent rebate
	16 cents +	1 cent rebate for each 1 cent decrease in State tax rate
	Maximum rebate - 5 cents	
Year 5 (14 cent Federal tax)	2-7 cents	1 cent rebate for each 3 cents increase in State tax rate
	8-15 cents	6 cent rebate
	16 cents +	1 cent credit for each 1 cent decrease in State tax rate
	Maximum credit - 6 cents	

centive for the States to remain in the 8 to 15 cent range would have to be provided or the differential probably would begin to widen again—unless the States' unpleasant experience with bootlegging was enough to convince them to maintain uniform rates without Federal encouragement.

Under this proposal any State that moved outside the 8 to 15 cent range would lose a 1 cent rebate for each 1 cent increase or decrease. The States might find the 15 cent maximum too limiting as their need for revenue increases. One approach would be to allow a 0.1 cent increase for every 4 percent increase in the consumer price index (CPI) with an adjustment to be made every 2 years. Assuming an inflation rate of 6 percent per year, this method would allow the range to rise 0.3 percentage points every 2 years. This formula is very arbitrary; others could be developed that would allow faster or slower increases. The formula could also be tied to some other measure, such as personal income, real gross national product, or cigarette sales.

A final feature of this proposal is that any money generated by the Federal excise tax and not rebated to the States would be allocated to the States to finance their enforcement efforts and/or used to finance Federal enforcement efforts in the event Federal contraband legislation is enacted.

To illustrate how this program would work, assume that North Carolina increased their rate 2 cents in the first year and 1 cent in each of the next 4 years. In the first year, they would receive a 1 cent Federal rebate and in each of the next 4 years an additional 0.5 cent rebate per year. At the end of 5 years, their State tax rate would be 8 cents and they would be receiving a 4 cent Federal rebate. Any increase in the rate beyond 8 cents would not earn a Federal rebate. The revenues that would have been raised by increasing the Federal excise tax and the dollar amounts of the rebates to the various States had the plan been administered in 1974 are shown in Table 13.

Several general objections can be raised against this approach. Although the States are allowed some flexibility, they almost are being forced to take an action that they would not take if they were not being bribed. States in the

upper end of the 15 cent range would have little room to raise their cigarette tax rate, while States at the lower end would have substantial latitude—a perverse effect. However, the 6 cent Federal tax increase would probably eliminate the desire of these States to raise the tax rate. Cigarette smokers nationwide would be subjected to a 6 cent increase in the cigarette tax—a regressive tax—in order to help solve a cigarette smuggling problem that exists to a substantial degree in only about a dozen States. (The total tax increase would be higher than 6 cents in low-tax States and less than 6 cents in high-tax States if the program achieved its intended result.) No assurance exists that the States would take the desired action, particularly in the case of the low-tax States. The 1 cent rebate for a 2 cent increase might not be attractive enough to encourage the tobacco-producing States to raise their cigarette tax rate. Even a one-for-one rebate might not overcome the traditional resistance to higher cigarette taxes. If the low-tax States failed to act, the plan would be largely ineffective.

A related problem is that the 8 to 15 cent range might still provide encouragement for substantial bootlegging. The following quote from the report of the New York State Special Task Force on Cigarette Bootlegging explains why this may be a problem:

Moreover, the differential in taxes which supplies the bootleggers profit unfortunately need not be as great now that the bootlegging importation and distribution systems and personnel have been established, as was required in order for bootlegging to have the incentive to increase to the extent it has in recent years, simply because now that such systems and personnel are 'in place' it requires less profit to continue to run it than it did to establish it. Consequently, a reduction of taxes back to the level just below the tax at which cigarette bootlegging flourished would not be sufficient to eliminate the profit differential; the reduction in taxes would have to be reasonably below the critical level above which bootlegging began to flourish.<sup>5</sup>



Table 13  
Estimated Payments to States Under Federal Incentive Plan

State	First Year 2 cent Rebate All States (In millions)	Fifth Year 6 cent Rebate All States (In millions)
Alabama	\$ 7.99	\$ 23.97
Alaska	1.01	3.03
Arizona	5.24	15.72
Arkansas	4.73	14.19
California	53.14	159.42
Colorado	6.54	19.62
Connecticut	6.80	20.40
Delaware	1.69	5.07
District of Columbia	2.55	7.65
Florida	21.34	64.02
Georgia	12.00	36.00
Hawaii	1.56	4.68
Idaho	1.97	5.91
Illinois	29.35	88.05
Indiana	17.31	51.93
Iowa	6.86	20.64
Kansas	5.60	16.80
Kentucky	14.97	44.91
Louisiana	10.05	30.15
Maine	2.94	8.82
Maryland	11.96	35.88
Massachusetts	14.62	43.86
Michigan	24.89	74.67
Minnesota	8.75	26.25
Mississippi	5.43	16.29
Missouri	12.95	38.85
Montana	1.81	5.43
Nebraska	3.52	10.56
Nevada	2.35	7.05
New Hampshire	4.34	13.02
New Jersey	17.92	53.76
New Mexico	2.31	6.93
New York	44.87	134.61
North Carolina	24.23	72.69
North Dakota	1.50	4.50
Ohio	26.31	78.93
Oklahoma	7.20	21.60
Oregon	6.99	20.97
Pennsylvania	27.13	81.39
Rhode Island	2.90	8.70
South Carolina	7.26	21.78
South Dakota	1.54	4.62
Tennessee	9.69	29.07
Texas	27.94	83.83
Utah	1.77	5.31
Vermont	1.46	4.38
Virginia	14.98	44.94
Washington	6.91	20.73
West Virginia	4.41	13.23
Wisconsin	10.36	31.08
Wyoming	1.15	3.45
2 Cent Federal Tax 1st Year and 6 cents 5th Year	\$533.30	\$1,659.90

Note: The figures in this table are only illustrative. To the extent that this proposal reduced cigarette smuggling, rebates in the fifth year, in most cases, would be significantly higher in high-tax States and lower in low-tax States.  
Source: Computed by the ACIR staff.

This problem could be largely eliminated by narrowing the range, but this step would reduce the States' flexibility and further infringe on State taxing prerogatives as well as increase the program costs.

Recognizing that there are disadvantages to the Federal incentive approach, some advocates defend it on the grounds that the only way cigarette bootlegging can be eliminated or reduced to a low level is to reduce the tax differential. Morris Weintraub, director of the Council Against Cigarette 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.

States will not take action on their own, according to the New York Commission of Investigation:

The record is clear that cigarette bootlegging could be ended totally and instantly in the city and State of New York by the elimination, or at least

sharp reduction, of the price disparity which is caused solely by the substantial differences in State excise taxes. Obviously, such a step would end all profits for the bootleggers and thereby end all bootlegging. This conclusion is clear and inescapable. But it is also clear and inescapable that this simply stated solution may be far from simple to achieve.<sup>6</sup>

The Federal incentive proposal might help to achieve this "simply stated solution," but until all other efforts are exhausted, it may be too radical an approach.

The enactment of Federal contraband legislation and greater enforcement efforts by the States can reduce bootlegging activity. The size of the reduction that can be achieved is difficult to estimate. Some experts have placed it as high as one-third. However, even if this great a reduction is achieved, many States will continue to suffer substantial revenue losses from cigarette bootlegging.

If bootlegging remains at an unacceptable level after all reasonable enforcement efforts have been tried, a Federal incentive plan as outlined above or the Federal tax credit described earlier in this chapter may become the logical approach.

#### FOOTNOTES

<sup>1</sup>Report of the New York State Special Task Force on Cigarette Bootlegging (Albany, N.Y.: Dept. of Taxation and Finance, May 1976).

<sup>2</sup>Joint Committee of the American Bar Association, the National Tax Association, and the National Association of Tax Administrators, *The Coordination of Federal, State and Local Taxation*, 1947, pp. 69-70.

<sup>3</sup>82nd Congress, 2nd Session, House Report No. 2519, 1953,

p. 69.

<sup>4</sup>Thomas W. Calmus, "The Burden of Federal Excise Taxes by Income Class," *Quarterly Review of Economics and Business*, Vol. 10, 1970, pp. 17-23.

<sup>5</sup>New York State Special Task Force in Cigarette Bootlegging, *op. cit.*, p. 7.

<sup>6</sup>State of New York Commission of Investigation, *Report of an Investigation Concerning the Illegal Importation and Distribution of Untaxed Cigarettes in New York State* (Albany, N.Y.: March 1972) p. 68.

# Cigarette Tax Administration

State cigarette tax administrators have organized their collection activities to obtain the revenue as close to the source as possible. The result is that the tax is collected from the consignees who first receive cigarettes from the manufacturers. These are primarily wholesalers and large retail outlets that buy directly from manufacturers. In all cases, tobacco manufacturers have a record of cigarettes distributed to the dealers who are responsible for the payment of State taxes—dealers who first receive the cigarettes are liable for the tax. Manufacturers do not have records that indicate the subsequent distribution of cigarettes to other wholesalers or retailers within or outside the State.

## USE OF STAMPS

In all but three of the 50 States, the payment of the cigarette tax is evidenced by the affixation of a transfer stamp or a meter impression on each pack of cigarettes. The exceptions are Alaska, Hawaii, and Michigan.

To compensate the wholesale distributor for the expense incurred by opening and repackaging cases and cartons to stamp each cigarette pack, the stamps and impressions are sold to the wholesaler at a discount from face value. In 1975, these discounts totalled \$86.6 million—2.5 percent of the total face value of all stamps

and impressions furnished by the vendors. The cost is borne by the States in the form of lower revenue from the cigarette tax. This additional cost results in either a higher State cigarette tax, lower expenditures on enforcement activities, reduced State services, or higher rates on other taxes. The question that must be answered is whether or not these costs are necessary for effective administration of the cigarette tax.

Stamps have been used as evidence of payment of cigarette taxes for several decades and are established firmly as the primary means of collecting the tax. Over the years, several States have expressed interest in abandoning stamps and using the return method of collection, but no action has been taken. Since 1947, every State that has enacted a cigarette tax has elected to use stamps or meter impressions.

## DISTRIBUTOR DISCOUNTS

The use of stamps and impressions creates two major administrative problems. Discounts allowed to wholesale distributors make the cigarette tax one of the most expensive taxes to administer. In some States, the compensation paid distributors exceeds the cost of affixing tax indicia, thereby providing cigarette wholesalers a source of income not enjoyed by other businesses that collect taxes for the State.

Table 14  
State Cigarette Tax Rates and Discounts, July 1, 1976

State	Tax Rate (Cents per Pack)	Discounts to Distributors	
		Statutory (In Percent Unless Shown (In Dollars or Cents)	In Dollars per Standard Case of 12,000 Cigarettes
Alabama	12c	7.5	\$5.40
Alaska <sup>a</sup>	8	1.0	0.48
Arizona	13	4.0;3.0;2.0 <sup>b</sup>	3.12;2.34;1.56
Arkansas	17.75	3.8	4.047
California	10	0.85	0.51
Colorado	10	4.0	2.40
Connecticut	21	1.0	1.26
Delaware	14	3/10 or 1c per pack	1.80
Florida	17	2.9 and 2.0 applicable to 15c of tax <sup>b</sup>	2.61 and 1.80
Georgia	12	3.0	2.16
Hawaii <sup>a</sup>	40% of wholesale price	—	—
Idaho	9.1	5.0	2.73
Illinois	12	1.67;1.33;1.0;0.67 <sup>b</sup>	1.20;0.96;0.72;0.48
Indiana	6	4.0	1.44
Iowa	13	3.0	2.34
Kansas	11	3.25	2.145
Kentucky	3	6.0 <sup>c</sup>	1.08
Louisiana	11	6.0	3.96
Maine	16	2.5	2.40
Maryland	10	3.25	1.95
Massachusetts	21	\$1.60 per 600 stamps	1.60
Michigan <sup>a</sup>	11	1.0	0.66
Minnesota	18	2.5;2.0;1.5 <sup>b</sup>	2.70;2.16;1.62
Mississippi	11	8.0	5.28
Missouri	9	2.0	1.08
Montana	12	3.0 <sup>d</sup>	2.16
Nebraska	13	5.0	3.90
Nevada	10	4.0	2.40
New Hampshire	12	2.75;2.375;2.0	1.98 - 1.44
New Jersey	19	1.46	1.66
New Mexico	12	4.0;3.0;2.0 <sup>b</sup>	2.88;2.16;1.44
New York	15	1.38 and 0.96 <sup>b</sup>	1.044 and 0.882
North Carolina	2	7/24c per stamp	1.75
North Dakota	11	3.0	1.98
Ohio	15	3-13% of 14/15 of tax (3.11%) <sup>e</sup>	2.80
Oklahoma	13	4.0	3.12
Oregon	9	1.67 mills per pack	1.00
Pennsylvania	18	3.0	3.24
Rhode Island	18	1.5	1.62
South Carolina	6	5.0	1.80
South Dakota	12	3.5	2.52
Tennessee	13	2.75;2.50;2.25;1.75 <sup>b</sup>	2.145;1.950;1.755;1.365
Texas	18.5	2.75	3.0525
Utah	8	4.0	1.92
Vermont	12	3.2	2.304
Virginia	2.5	2.5c per carton	1.50
Washington	16	1.682 on 11c <sup>f</sup>	1.11
West Virginia	12	4.0	2.88
Wisconsin	16	2.1	2.016
Wyoming	8	6.0	2.88
District of Columbia	13	2.0	1.56

(Footnotes on following page.)

Table 14 (continued)  
State Cigarette Tax Rates and Discounts, July 1, 1976

<sup>a</sup>Alaska, Hawaii, and Michigan do not use tax indicia in administering cigarette tax.

<sup>b</sup>The following States have graduated discounts:

Arizona: 4 percent on first \$30,000 stamps per month; 3 percent of next \$30,000; 2 percent of excess.  
Florida: (applicable to 15c of tax) 2.9 percent of value of first 2 million stamps purchased during fiscal year; 2 percent of excess.  
Illinois: 1.67 percent on first \$700,000 taxes paid during fiscal year; 1.33 percent of next \$700,000; 1.0 percent of next \$700,000; and 0.67 percent of any additional purchases.

Minnesota: 2.5 percent on first \$500,000 stamps purchased during fiscal year; 2 percent on next \$500,000; and 1.5 percent on additional purchases.

New Hampshire: 2.75 percent on purchases up to \$500,000 per year; 2.375 percent on the next \$500,000; and 2 percent on additional purchases.

New Mexico: 4 percent on first \$30,000 stamps purchased in any month; 3 percent of second \$30,000; and 2 percent on additional purchases.

New York: 1.38 percent on purchases up to \$1,500,000 during calendar year and 0.96 percent on additional purchases.

Tennessee: 2.75 percent on first 3,000 cases per fiscal year; 2.5 percent of next 3,000 cases; 2.25 of next 9,000 cases; and 1.75 percent of excess.

<sup>c</sup>Kentucky allows a discount of 18c for each \$3 of tax evidence.

<sup>d</sup>Montana allows a discount of 8 percent on 4.5c of tax (3 percent of the full 12c tax).

<sup>e</sup>Ohio allows a discount of 3-1/3 percent of 14/15 of the tax value of stamps (3.11 percent of full 15c tax).

<sup>f</sup>Washington has different discounts applied to basic and added taxes up to 11c of tax. A composite percentage discount figure is shown.  
Source: Federation of Tax Administrators, *Comparative Cigarette Tax Collections, Per Capita Cigarette Tax Collections, Per Capita Cigarette Consumption, by States—1975* (Chicago, Ill.: September 1976).

These problems have been exacerbated in recent years because State legislatures have raised cigarette tax rates frequently and these increases have often been accompanied by higher payments to distributors. When a State raises its cigarette tax rate, the amount of discount per case increases proportionately, unless an adjustment is made.

Alexander C. Wiseman, in a 1978 doctoral dissertation on the demand for cigarettes, commented on this situation:

It is difficult to see why distributors are given a percentage discount from face value of stamps purchased, since the cost of stamp affixing is not related to the denomination of the stamps itself. A more logical procedure would be to grant a discount of so much per stamp purchased, and try to make the discount per stamp equal to the cost of affixing it. Under the present system increases in tax rates, unless accompanied by appropriate decreases in discount rates, result in increases in the compensation per package stamped. Hence, total discounts to distributors increased from \$45.9 million in fiscal 1965 to \$48.2 million in fiscal 1966, although State tax paid sales were less in the latter period . . . This amounted to an increase of slightly over 5 percent in the discount per package for the United States as a

whole, although in the period no States increased their discount rates and several reduced them.<sup>1</sup>

The cost of cigarette tax administration, exclusive of discounts, is comparable to that of other excise taxes. However, in the 47 States (plus the District of Columbia) using stamps or meter impressions, administrative expenses, discounts, stamps, and enforcement activities represent a significantly larger percentage of collections than for any other major tax.

The percentage discount allowed distributors ranges from 0.85 percent in California to 8 percent in Mississippi and 10 percent in Virginia. (See Table 14.) Ten States have a discount rate of 5 percent or more and seven States allow discounts of 2 percent or less. Graduated discounts are used in eight States; the discounts decline as the sale of stamps increase, on the premise that smaller distributors incur higher stamping costs on a per case basis.

The statutory discount in itself does not provide adequate information about costs to the State because payments to distributors also depend on the tax rate. For example, Idaho, Nebraska, and South Carolina allow 5 percent discounts. However, the payments to distributors per a standard case of 12,000 cigarettes vary from \$1.80 in South Carolina (where the tax rate is 6 cents) to \$2.73 in Idaho (9.1 cent rate) and \$3.90 in Nebraska (13 cent rate).

For a valid comparison of payments to distributors, the discount rate must be multiplied

Table 15  
Distribution of State Cigarette Discounts

Distributors Discounts	Number of States (includes D.C.)
No discount	1
up to \$0.99	3
\$1.00 - 1.49	8
\$1.50 - 1.99	12
\$2.00 - 2.49	10
\$2.50 - 2.99	8
\$3.00 - 3.99	6
\$4.00 - 4.99	1
\$5.00 and over	2
<b>TOTAL</b>	<b>51</b>

Source: ACIR staff compilation from data in, Federation of Tax Administrators, *Comparative Cigarette Tax Collections, Per Capita Cigarette Tax Collections, Per Capita Cigarette Consumption, by State—1975* (Chicago, Ill.: September 1976).

by the tax on a case of cigarettes (600 packs x tax rate) to determine the dollar amount of the discount per case. The computation reveals that the variance in discounts among the States is even larger than indicated by the actual statutory discounts. (See Table 14.) For the 47 States using stamps, the discount per case varies from 51 cents in California to \$5.28 in Mississippi. The discounts range from \$1.00 to \$2.99 in about 75 percent of the States, with 43 percent between \$1.50 and \$2.49. (See Table 15.) These wide differences prevail among the States even though stamp-affixing procedures are generally standardized throughout the country.

No evidence exists to demonstrate that the variance in discounts is the result of regional cost differences. For example, among western States, the discounts vary from 51 cents in California to \$2.88 in Wyoming. In the South, the discounts range from \$1.08 in Kentucky to \$5.40 in Alabama. In the Midwest, distributors are paid up to \$1.20 in Illinois, \$1.44 in Indiana, and \$3.90 in Nebraska.

In 1963, the cost of discounts was \$42.8 million—3.6 percent of net cigarette tax revenues. By 1975, the cost of discounts had increased 102.3 percent to \$86.6 million (2.5 percent of net revenues). (If an adjustment is made for North Carolina and Oregon, which did not have cigarette taxes in 1963, the increase is 92.5 percent.) The increase is well in excess of the 75.2 percent rise in the U.S. consumer price

index during the same period.

Total package sales of cigarettes increased only 21.6 percent over the 12-year period compared with the 102.3 percent increase in the cost of discounts. As a result, the discount per pack increased 63.2 percent between 1963 and 1973. However, in the past 2 years, the rate of inflation has been well in excess of the increase in distributor discounts, narrowing the gap between discounts and the cost of affixing indicia.

Discounts as a percent of net revenues fell because many States reduced their discounts as rates increased. However, 16 States increased or did not change their discounts despite increased tax rates. Between January 1, 1972 and July 1, 1974, nine States raised cigarette tax rates and, of these, four made no change or raised their percentage discounts, thereby increasing their discounts in dollar terms. During the same period, two States that did not change their tax rate lowered their discount and two States raised their discount. Between January 1, 1975 and July 1, 1976, four States and the District of Columbia (twice) raised their tax rates and, in all cases but one, lowered the percentage discount. Two States that did not change their rate increased their discounts.

The wide range among the States in the amount of the distributor discount per case and the failure of many States to adjust discounts as tax rates change demonstrates rather clearly the lack of a relationship between distributor costs and reimbursements received from the States. There is little data available indicating the appropriate level of reimbursement for affixing indicia, but the few existing studies indicate that overpayment of distributors by States is the rule rather than the exception.<sup>2</sup>

The National Association of Tobacco Distributors does not agree with this conclusion. They have recently estimated the cost of affixing indicia at 7.41 percent, which is higher than the discount allowed in every State except Alabama and Mississippi.

Some have suggested that the States have been generous with discounts in an effort to appease tobacco wholesalers, who are generally a major source of opposition to increases in the cigarette tax rate. Whatever the reason, there are ample grounds to question whether or not States should continue to spend such large sums for distributor discounts.

States could rationally shift the basis of the distributor discount to a fixed amount per stamp and, to the extent possible, make the discount equal to the cost of stamp affixing. Five States currently have a discount based on a fixed amount per stamp. In these States, the cost per case of the discount varies from \$1.00 to \$1.80, which is well below the 50-State average of \$3.13 per case.

### STAMPS AS AN ENFORCEMENT AID

Stamps were introduced to provide evidence that the cigarette tax was paid and to make tax avoidance more difficult. Given the increase in bootlegging and counterfeit stamping, there is some reason to question whether or not undue reliance has been placed on the efficacy of stamps and other indicia. The cost of affixing stamps is so great that less money is spent on law enforcement and auditing procedures than is needed to insure efficient collection of the cigarette tax. It is difficult to make comparisons between States that use stamps and those that do not. Michigan is comparable to other States, while Hawaii and Alaska do not border on other States and, thus, are not subject to smuggling problems. Michigan's cigarette tax collections appear to be as efficient and effective as any other State's. (Although Michigan borders on a low-tax State (Indiana), per capita sales in fiscal year 1975 were 4.5 percent above the national average.) Michigan is aided in its enforcement efforts to an unknown extent by other States' use of indicia. It is possible that if other States stopped using stamps, Michigan would have more enforcement problems.

State tax administrators have not indicated any active interest in collecting the cigarette tax without the use of indicia and there is no evidence that such interest can be generated in the near future. The general view of administrators is that the cigarette tax cannot be collected without the use of stamps unless tax rates become uniform.

### CENTRALIZED CIGARETTE TAX COLLECTION

Can the cigarette tax be collected effectively by some method other than requiring distri-

butors to break open cases and affix indicia to each pack?

**Collection With Stamps.** One approach would be to collect the tax at the source by requiring the manufacturer to imprint each State's indicia at the packaging stage. However, the burden placed on the manufacturer makes this proposal impractical. Indicia could be affixed easily, but the warehousing and transportation problems would be substantial. The manufacturer would have to maintain at least 51 different inventories for distribution to each State. Because of such problems, this proposal has garnered little support and has been strongly opposed by cigarette manufacturers.

The major stumbling block to central collection of the cigarette tax at the manufacturing level is the requirement that indicia be attached to each package to evidence payment of the tax. If this requirement were eliminated, many of the problems that would otherwise be encountered in cigarette packaging, shipping, and storing would be largely removed.

**Collection Without Stamps.** Under another approach to centralized collection, the manufacturer would affix to the invoice the amount of tax paid in the State to which the cigarettes are being shipped. Packaging, storing, and shipping routines would not be disturbed under this proposal, and only a slight change in the billing procedure would be required. The State would take responsibility at the point of delivery. If the cigarettes are distributed to retailers within the State, there would be no collection problems. If the cigarettes are sold to retailers or distributors in other States with different tax rates, adjustments would have to be made on the distributors' tax returns. The distributor would remit the additional tax due to the State of receipt or claim a refund from his own State. Each State would remit to another State the precollected tax due on shipments originally received in the State but subsequently sold to retailers or distributors in other States. The process would require increased auditing and changes in the States' accounting procedures, but most States could meet these requirements with little difficulty.

The collection of the cigarette tax at the manufacturing level would increase costs for tobacco manufacturers, and they could be expected to ask for reimbursement. States

Table 16  
**Estimated Gross Cigarette Tax Revenue and Amounts Retained by  
 Distributors as Discounts for Affixation of Tax Indicia and  
 Compensation for Cost of Collection, 1975**

State	Estimated Gross Revenue (In thousands)	Estimated Amounts Retained by Distributor (In thousands)
Alabama	\$ 49,412	\$ 3,706
Alaska	4,492	45
Arizona	35,462	890
Arkansas	43,315	1,646
California	267,485	2,274
Colorado	33,252	1,330
Connecticut	72,184	722
Delaware	11,740	251
Florida	183,829	3,517
Georgia	72,957	2,189
Hawaii	9,164 <sup>1</sup>	0
Idaho	9,106	455
Illinois	177,645	1,990
Indiana	52,080	2,083
Iowa	45,545	1,366
Kansas	31,397	1,020
Kentucky	23,261	1,396
Louisiana	56,374	3,382
Maine	23,883	597
Maryland	48,546	1,932
Massachusetts	125,856	1,873
Michigan	137,979	1,380
Minnesota	80,026	1,577
Mississippi	30,678	2,454
Missouri	58,537	1,171
Montana	10,838	325
Nebraska	23,365	1,168
Nevada	11,760	470
New Hampshire	26,940	741
New Jersey	170,340	2,487
New Mexico	13,953	468
New York	338,015	4,522
North Carolina	24,925	3,634
North Dakota	8,531	256
Ohio	198,108	6,161
Oklahoma	48,009	1,920
Oregon	30,953	574
Pennsylvania	249,456	7,484
Rhode Island	21,939	375
South Carolina	22,078	1,104
South Dakota	9,280	325
Tennessee	64,814	1,483
Texas	260,052	7,151
Utah	7,387	295
Vermont	9,169	293
Virginia	19,067	1,907
Washington	55,797	767
West Virginia	26,989	1,080
Wisconsin	83,720	1,758
Wyoming	4,671	280
District of Columbia	8,069	313
<b>TOTALS</b>	<b>\$3,432,431</b>	<b>\$86,577</b>

<sup>1</sup>Includes nonsegregable amount of tobacco products.

Source: Federation of Tax Administrators, *Comparative Cigarette Tax Collections by State—1975* (Chicago, Ill.: September 1976).

would also incur higher costs for increased auditing. These costs, however, could easily be met out of a small portion of the money currently paid in the form of discounts to distributors. The money saved by the States could be used to increase enforcement efforts, to reduce the cigarette tax or other taxes, or to provide increased government services.

In addition to the savings on discounts, the States would benefit from an improved level of tax compliance. The precollection of the States' taxes would have the effect of a one-time acceleration of the States' collections but the date of accountability is a negotiable matter in which the States might be disposed to accommodate the convenience of manufacturers.

The revenue involved in the restructure of the cigarette tax collection process is about \$87 million a year. (See Table 16.) The quality of tax enforcement, administrative efficiency, and

the prudent expenditure of taxpayers' money are also involved. Tax administrators and tobacco industry officials believe that the collection of the cigarette tax without stamps would result in an increase in cigarette bootlegging activity. Nonetheless, the collection of cigarette taxes without stamps appears to warrant continuing consideration, particularly if cigarette tax rates become more uniform.

#### FOOTNOTES

<sup>1</sup>Alexander C. Wiseman, "The Demand for Cigarettes in the United States: Implications for State Tax Policy," doctoral dissertation, University of Washington, January 1968, pp. 95-96.

<sup>2</sup>ACIR, *State-Federal Overlapping in Cigarette Taxes* (Washington, D.C.: Government Printing Office, September 1964) pp. 43-44.

## Cigarette Bootlegging— Impact on State Revenues

Cigarette bootlegging has a definite impact on States through loss of revenues. In order to judge the need for legislative action in fighting cigarette smugglers, estimates have been developed that clarify the magnitude of the State revenue losses involved. The total volume of smuggling traffic must be based on indirect measures, because bootleggers do not publish data and law enforcement reports offer little in the way of a comprehensive accounting of smuggling. One indirect measure of smuggling is the deviation of State per capita sales from the U.S. average. Deviations for each State are shown in Table 17. States that lose revenues from bootlegging ideally would show up on the table as below average in per capita sales, while States that gain from bootlegging would have above average per capita sales.

The problem with using these deviations directly as a bootlegging measure is that they are not entirely the result of bootlegging. Cigarette demand studies in recent years have indicated the importance of other variables that significantly affect per capita cigarette sales, many of which are unrelated to bootlegging. Thus, the deviation measure alone lacks the requisite accuracy to measure revenue losses due to bootlegging.

### SOCIAL AND DEMOGRAPHIC FACTORS

One reason States have different per capita cigarette sales is because people's tastes and preferences differ. The age distribution of the population, for example, is likely to be a key determinant of per capita cigarette sales because adults are the main consumer group. A State with a relatively large percentage of the population over the legal age should have higher per capita sales, other elements being equal.

The percent of resident population exempt from the cigarette tax also may lead to variations in per capita sales data. Military personnel and Indians on reservations are exempt from both cigarette excise and sales taxes, but nonetheless they are included in the State population count. Because sales data is only available for tax-paid cigarettes, States with large exempt populations will have lower per capita sales than the average, other elements being equal.

Tourist populations, which are, of course, not counted in the resident population, tend to have the opposite effect on per capita sales. States that benefit from tourism generally have high



per capita sales. This effect is particularly pronounced for States with small resident populations, such as Nevada. Per capita cigarette sales in Nevada were 57 percent higher than the U.S. average in fiscal year 1975, largely because of tourism.

Other social and demographic variables that are associated with variations in State per capita sales include religion, region, and the male-female population ratio. The existence of a large religious population that explicitly

forbids smoking can significantly reduce a State's per capita sales. For example, the Mormon population in Utah helps explain its per capita sales at half the national average.

The male-female ratio may also be related to the level of smoking. (See Table 18.) Surveys indicate that a larger proportion of men than women smoke cigarettes. States with high male-female ratios should be high in per capita sales, other elements being equal. However, the statistical evidence of the link be-

Table 17  
Deviation of State Per Capita Sales from National Average  
(Fiscal Year 1975)

State	Actual Per Capita Sales (Packs)	Deviation From National Average <sup>1</sup> (Packs)
United States, Average	130.9	
Alabama	111.7	-19.2
Alaska	150.4	19.5
Arizona	121.8	-9.1
Arkansas	114.8	-16.1
California	127.1	-3.8
Colorado	131.0	0.1
Connecticut	110.2	-20.7
Delaware	147.6	16.7
District of Columbia	176.5	45.6
Florida	131.9	1.0
Georgia	122.9	-8.0
Hawaii	92.4	-38.5
Idaho	123.3	-7.6
Illinois	131.8	0.9
Indiana	162.4	31.5
Iowa	120.5	-10.4
Kansas	123.4	-7.5
Kentucky	223.0	92.1
Louisiana	133.6	2.7
Maine	140.7	9.8
Maryland	146.1	15.2
Massachusetts	126.1	-4.8
Michigan	136.8	5.9
Minnesota	111.5	-19.4
Mississippi	116.8	-14.1
Missouri	135.6	4.7
Montana	123.7	-7.2
(Continued)		

tween smoking and sex is weak; at least one study has found sex to be insignificant in explaining variations in State per capita sales.<sup>1</sup>

The regional differences in per capita sales originally may have been associated with the factors discussed above and have since taken on an importance of their own. The justification for this is the habit-forming nature of smoking. Thus, States that originally had large religious memberships with groups intolerant of smoking may still have low per capita sales de-

spite a relative decline in religious population.

Related to the regional variable is the geographical distribution of the population, with population density and the urban-rural population ratio as the most likely variants that could be applied to explain variations in per capita sales. The rationale behind this factor is that cigarette smoking is a social phenomenon more common among dense populations than among widely scattered individuals.

Tastes and preferences as influenced by

Table 17 (continued)  
Deviation of State Per Capita Sales from National Average  
(Fiscal Year 1975)

(State continued)	Actual Per Capita Sales (Packs)	Deviation From National Average <sup>1</sup> (Packs)
Nebraska	114.1	-16.8
Nevada	205.2	74.3
New Hampshire	269.1	138.2
New Jersey	122.3	-8.6
New Mexico	103.1	-27.8
New York	123.9	-7.0
North Carolina	226.0	95.1
North Dakota	117.9	-13.0
Ohio	122.5	-8.4
Oklahoma	132.9	2.0
Oregon	154.4	23.5
Pennsylvania	114.6	-16.3
Rhode Island	154.7	23.8
South Carolina	130.5	-0.4
South Dakota	113.5	-17.4
Tennessee	117.4	-13.5
Texas	116.0	-14.9
Utah	75.8	-55.1
Vermont	155.5	24.6
Virginia	152.7	21.8
Washington	99.5	-31.4
West Virginia	123.2	-7.7
Wisconsin	113.5	-17.4
Wyoming	160.7	29.8

<sup>1</sup>Weighted average of all taxing States.

Source: ACIR staff compilation from data in, Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol. 10, Table 11, p. 22.

**CONTINUED**

**1 OF 3**

advertising may have a large effect on cigarette consumption over time. But it is not clear whether advertising creates any variation in per capita sales among States.

ECONOMIC FACTORS

Price and income effects on the demand for cigarettes are probably as important as the social and demographic variables in explaining variations in State per capita cigarette sales. According to elementary supply-demand theory, if a cigarette is a normal good, then per capita sales will be directly related to per capita income. Most cigarette demand studies postulate such a relationship; that is, States with high per capita income have high per capita sales, other elements being equal.

An even more fundamental law of economics dictates that as the price rises, the quantity demanded falls; hence, States with high-priced cigarettes will have low consumption, other elements equal. Although the extent to which demand is responsive to price is a debatable question, even with a relatively unresponsive demand the effect may be substantial because price varies considerably from one State to another. This price differential is almost totally the result of the difference in State sales and excise taxes. The important point to be made here is that high taxes (or high prices) generally reduce consumption, other elements being equal, and even if tax differentials had no effect on bootlegging, there would be lower consumption in high-tax States.

FACTORS AFFECTING BOOTLEGGING

Although all the aforementioned economic, social, and demographic variables have a significant impact on per capita sales, cigarette bootlegging still is believed to cause a large share of the interstate variation in cigarette sales. Because no direct data is available on bootlegging, one must examine the factors that determine bootlegging and measure their effects on per capita cigarette sales.

The most commonly recognized determinant of bootlegging is the tax differential (or price differential) between a State and its closest neighbors. If a State has a higher tax on cigarettes than its neighboring border States, the

Table 18  
Cigarette Smoking Incidence Related to Demographic Characteristics, United States (September - October 1972<sup>1</sup>)

Item	Percent of Sample <sup>2</sup>	
	Adults (18 and over)	Youth (ages 12-17)
All current smokers	38	17
Male	42	17
Female	34	17
Age		
12-13		4
14-15		16
16-17		32
18-21	42	
22-25	47	
26-34	48	
35-49	44	
50 and over	24	
Race		
White	37	
Other	46	
Region		
Northeast	38	16
North Central	35	19
South	42	17
West	35	16

<sup>1</sup>U.S. Commission on Marijuana and Drug Abuse, *Drug Use in America: Problems in Perspective* (Washington, D.C.: 1973) p. 46.  
<sup>2</sup>Figures are not additive; thus, they do not total 100 percent. Sample size was: adults, 2,411; youth, 880.  
Source: Robert H. Miller, "Factors Affecting Cigarette Consumption," paper presented at 1974 National Tobacco Tax Association annual meeting.

border States will gain in per capita sales from the bootlegging of cigarettes to the high-tax State, while the high-tax State in turn will experience low per capita sales, other elements being equal.

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 the along Massachusetts-New Hampshire border, the majority of smuggling probably is done by the ultimate consumer.)

The amount of smuggling depends on other factors in addition to the tax differential, such as the accessibility of retail outlets in the low-tax State to significant population centers in the high-tax State. Thus, length of border, population, and distance of population from the border all affect the magnitude of bootlegging gains and losses, which cause State per capita sales to vary.

Large-scale interstate smuggling, often over long distances, such as the smuggling of cigarettes from North Carolina to New York, has little to do with border State tax differentials. It depends on the differential between the high-tax, receiving State and the low-tax State from which the contraband originates. Only the lowest taxing State in a region is likely to benefit from this type of bootlegging, and, in general, the higher the State tax, the more likely the State will lose in per capita sales from interstate smuggling.

Other important factors related to both across-border and interstate smuggling are the distance between State population centers and the risk of arrest and seizure of contraband. Increased law enforcement activity could alter the pattern of interstate bootlegging by increasing the risk component of the cost of bootleg cigarettes from certain key, low-tax States. But without an overall, 50-State effort, only the pattern would be affected and bootlegging could continue from other low-tax, low-risk States.

RESULTS OF THE STATISTICAL ANALYSIS

Multiple regression analysis was employed in this study to determine the factors that best explain per capita cigarette sales among the States in 1975. The resulting per capita sales estimates were compared to the estimated per capita sales for each State, assuming that only nonbootlegging factors determine demand and that average per capita sales for the 50 States is the same with or without bootlegging. This method allows a comparison between sales under the present bootlegging conditions and

sales as if bootlegging could be eliminated, given the present tax structure.

Among the variables deemed significant in explaining per capita cigarette consumption in 1975 are tourism, religion, region, age distribution of population, per capita income, cigarette and sales tax rates, cigarette price, and the price differential between border States. For the purpose of estimating per capita sales, the tax rate was used instead of the price because most variations in price are due to tax variations and because the tax rate was more significant in explaining per capita sales. The urban-rural, male-female, advertising, and military exemption variables were excluded both for simplicity and because previous studies indicated they were relatively unimportant or insignificant. Likewise, population density and the percent of population living on Indian reservations were found to be statistically insignificant. (For a detailed discussion of the model tested and the estimates obtained, see Appendix B.)

For each State, estimated per capita sales figures were multiplied by the State cigarette excise tax rate, the State sales tax rate, and the average local cigarette tax rate to obtain the estimated current revenue from the sale of cigarettes. (See Table 19, column 1.)

One way to assess the cost of the present pattern of cigarette tax differentials and the bootlegging that accompanies the differentials is to compute the hypothetical per capita sales that would result if no bootlegging occurred. Estimated revenues are computed by applying the current State tax rates to the hypothetical per capita sales figures. A comparison of these revenue estimates with those obtained earlier is also presented in Table 19.

The gain and loss estimates in columns 3 and 4 of Table 19 give a rough indication of which States gain or lose from bootlegging. (The method used to estimate hypothetical per capita sales is detailed in Appendix B.) Briefly, this method allows per capita sales to vary among the States only to the extent that the States differ with respect to variables deemed unrelated to bootlegging. These variables include tourism, religion, per capita income, and region. The tax on cigarettes also was included, but only to the extent that it affects consumption. The values of these factors for each State

were multiplied by the regression coefficients previously obtained to provide hypothetical per capita sales figures for each State. These were in turn scaled to constrain the mean value of the hypothetical estimates to equal that of the previous estimates.

All estimates of bootlegging losses and gains face the extreme statistical problem of predicting what would happen if we lived in a world much different from the present, and they are all subject to a certain degree of error.

The estimates produced by this methodology are in some cases lower than those produced by the individual States. For example, the New York State Special Task Force on Cigarette Bootlegging has estimated the fiscal year 1975

revenue loss due to bootlegging at \$78 million. This estimate assumes that New York cigarette sales as a percentage of U.S. consumption are the same today as in the prebootlegging era—i.e., before 1965. It does not, however, take into account changes in income, population mix, tax rate, and price in New York relative to the Nation. For example, in 1964 the average cigarette tax rate nationwide was 5.6 cents and the New York tax rate was 5 cents. In 1975, the U.S. average tax rate was 12.2 cents and the New York tax rate was 15 cents; the 8 cent New York City cigarette tax and the sales tax on cigarettes increased the tax burden on cigarettes in New York even further above the U.S. average cigarette tax.

Table 19  
Cigarette Tax Evasion—Winners and Losers  
(Dollar Amounts in Millions)

State	Estimated Cigarette Tax Revenues <sup>1</sup>		Estimated Gain or Loss (—) (Col. 1-Col. 2) (3)	Gain or Loss (—) as Percent of Col. 1 (4)
	Current Levels <sup>2</sup> (1)	Assuming No Tax Evasion <sup>3</sup> (2)		
Alabama	\$ 64.1	\$ 71.0	\$ -6.9	-10.8%
Alaska	4.1	3.9	0.2	4.9
Arizona	36.1	39.5	-3.4	-9.4
Arkansas	41.1	47.6	-6.5	-15.8
California	360.5	376.5	-16.0	-4.4
Colorado	34.4	34.1	0.3	0.9
Connecticut	75.6	90.7	-15.1	-20.0
Delaware	11.5	11.7	-0.2	-1.7
District of Columbia	11.3	11.1	0.2	1.8
Florida	204.3	240.0	-35.7	-17.5
Georgia	82.8	85.6	-2.8	-3.4
Hawaii	NA	NA	NA	NA
Idaho	10.5	10.2	0.3	2.9
Illinois	221.6	243.3	-21.7	-9.8
Indiana	58.6	54.6	4.0	6.8
Iowa	56.1	60.1	-4.0	-7.1
Kansas	37.8	39.4	-1.6	4.2
Kentucky	38.1	24.8	13.3	34.9
Louisiana	61.0	63.1	-2.1	-3.4
Maine	20.4	22.5	-2.1	-10.3
Maryland	70.8	70.6	0.2	0.3
Massachusetts	122.0	134.1	-12.1	-9.9
Michigan	160.1	167.0	-6.9	-4.3
Minnesota	82.0	94.2	-12.2	-14.9
Mississippi	36.0	37.3	-1.3	-3.6
Missouri	81.5	86.5	-5.0	-6.1
Montana	11.0	11.3	-0.3	-2.7
Nebraska	26.5	28.2	-1.7	-6.4

(Continued)

Between 1964 and 1975, the average retail price of cigarettes in New York increased 91.4 percent, while the average U.S. price increased capita personal income increased only 106.2 percent, while U.S. average per capita personal income increased 126.7 during this same time period.

All these factors could account for the fact that in 1975, New York per capita cigarette sales were 5.4 percent below the U.S. average, while in 1964 sales were 13.6 percent above the U.S. average. It follows that the New York estimate of revenue loss due to bootlegging is probably overstated. Many of the estimates of bootlegging revenue losses are deficient in that they do not consider the effect on demand of a

change in price nor of the changes in other demographic and economic factors, such as population and income.

An analysis of the ACIR estimates of bootlegging losses and gains leads to the following conclusions:

- 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 per-

Table 19  
Cigarette Tax Evasion—Winners and Losers  
(Dollar Amounts in Millions)

(continued)	Estimated Cigarette Tax Revenues <sup>1</sup>		Estimated Gain or Loss (—) (Col. 1-Col. 2) (3)	Gain or Loss (—) as Percent of Col. 1 (4)
	Current Levels <sup>2</sup> (1)	Assuming No Tax Evasion <sup>3</sup> (2)		
Nevada	13.5	13.1	0.4	3.0
New Hampshire	24.2	12.9	11.3	46.7
New Jersey	169.4	195.4	-26.0	-15.3
New Mexico	16.8	17.8	-1.0	-6.0
New York	414.5	486.8	-72.3	-17.4
North Carolina	49.0	32.4	16.6	33.9
North Dakota	10.3	10.5	-0.2	-1.9
Ohio	26.3	223.2	-16.9	-8.2
Oklahoma	43.8	45.0	-1.2	-2.7
Oregon	29.7	28.2	1.5	5.1
Pennsylvania	262.7	298.3	-35.6	-13.6
Rhode Island	17.4	17.7	-0.3	-1.7
South Carolina	32.2	30.8	1.4	4.3
South Dakota	10.1	10.2	-0.1	-1.0
Tennessee	77.5	85.3	-7.8	-10.1
Texas	249.0	292.1	-43.1	-17.3
Utah	9.5	9.2	0.3	3.2
Vermont	9.1	8.1	1.0	11.0
Virginia	49.1	46.6	2.5	5.1
Washington	70.3	83.5	-13.2	-18.8
West Virginia	32.6	34.5	-1.9	-5.8
Wisconsin	95.9	109.5	-13.6	-14.2
Wyoming	4.4	4.2	0.2	4.5
TOTAL	\$3,917.0	\$4,254.2	-\$337.1 <sup>4</sup>	8.6%

<sup>1</sup>Total includes State and local cigarette tax, plus State sales tax.

<sup>2</sup>Current tax rates are applied to estimated per capita sales.

<sup>3</sup>Current rates are applied to hypothetical per capita sales.

<sup>4</sup>The total loss to the "losing" States is \$390.8 million.

Source: ACIR staff estimates based on cross-section analysis of 1975 cigarette sales for 49 States and the District of Columbia; see Appendix B.

cent), 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 revenues for the States 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.

#### FOOTNOTES

<sup>1</sup>Paul B. Manchester, "An Econometric Analysis of State Cigarette Taxes, Prices, and Demand, With Estimates of Tax-Induced Interstate Bootlegging," a thesis submitted to the University of Minnesota, August 1973, pp. 37-38.

## Appendices

- Appendix A** Selected Statistics on Cigarette Taxes
- Appendix B** Description of Statistical Methodology Used to Estimate Cigarette Sales and Revenue Impact of Cigarette Bootlegging
- Appendix C** Proposed Federal Legislation to Implement ACIR Recommendations With Respect to Cigarette Bootlegging
- Appendix D** Testimony Presented to the Advisory Commission on Intergovernmental Relations, December 16, 1976

Appendix A  
Selected Statistics on Cigarette Taxes

Table A-1  
Municipal Cigarette Tax Rates for Selected States, FY 1975

State	Number of Jurisdictions Levying Tax	Tax Rate (Cents)	Weighted Average Tax Rate (Cents)	Total Revenue	Number of Packs Taxed Locally (In thousands)	Per Capita Sales in Taxing Localities (Packs)	Per Capita Sales in Localities as Percent of State Average
Alabama <sup>1</sup>	237	1-5	NA	\$8,617,135	NA <sup>2</sup>	NA	NA
Missouri	101	1-10	4.9	18,711,066	383,458	105.7	77.9%
Illinois	2 <sup>3</sup>	5	5	18,331,618	366,632	112.2	85.1
New Jersey	1 <sup>4</sup>	3	3	247,323	8,244	190.0	155.4
New York	1 <sup>5</sup>	4, 7 & 8 <sup>6</sup>	6	45,410,075	755,483	99.8	80.5
Tennessee	2 <sup>7</sup>	1	1	912,462	91,246	125.6	107.0
Virginia	21	2-10	6.5	13,004,215	198,723	97.6	63.9

N.A. Not available  
<sup>1</sup>Some Alabama data is for fiscal year 1974.  
<sup>2</sup>Jurisdictions taxing cigarettes represent 75.3 percent of State population.  
<sup>3</sup>Chicago and Rosemont.  
<sup>4</sup>Atlantic City.  
<sup>5</sup>New York City.  
<sup>6</sup>Eight cents effective January 1, 1976.  
<sup>7</sup>City of Memphis and Shelby County.  
Source: ACIR staff compilation from data provided by the Tobacco Tax Council, Inc., Richmond, Va.



Table A-2  
Per Capita Cigarette Sales and Tax Rates by Region,  
and Tax-Paid Sales by State and Region, FY 1975

	Per Capita Sales <sup>1</sup>	Average Tax Rate	Weighted Tax Rate <sup>2</sup>	Tax-Paid Sales (in Millions of Packs)
<b>New England</b>	135.7	16.67	18.80	1,654.7
Maine				147.3
New Hampshire				217.4
Vermont				73.1
Massachusetts				731.6
Rhode Island				145.0
Connecticut				340.3
<b>Middle Atlantic</b>	120.7	17.33	16.70	4,496.3
New York				2,243.7
New Jersey				896.1
Pennsylvania				1,356.5
<b>East North Central</b>	132.1	12.00	11.92	5,412.2
Ohio				1,315.7
Indiana				865.8
Illinois				1,467.5
Michigan				1,244.8
Wisconsin				518.4
<b>West North Central</b>	122.1	12.43	12.41	2,037.5
Minnesota				436.8
Iowa				344.0
Missouri				647.9
North Dakota				75.1
South Dakota				77.4
Nebraska				176.1
Kansas				280.2
<b>South Atlantic</b>	149.0	9.83	8.61	5,022.9
Delaware				84.6
Maryland				598.0
District of Columbia				127.6
Virginia				749.4
West Virginia				220.6
North Carolina				1,211.9

(Continued)

Table A-2 (continued)  
Per Capita Cigarette Sales and Tax Rates by Region,  
and Tax-paid Sales by State and Region, FY 1975

	Per Capita Sales <sup>1</sup>	Average Tax Rate	Weighted Tax Rate <sup>2</sup>	Tax-Paid Sales (in Millions of Packs)
(continued)				
South Carolina				363.3
Georgia				600.1
Florida				1,067.4
<b>East South Central</b>	140.6	9.75	8.51	1,904.3
Kentucky				748.6
Tennessee				484.6
Alabama				399.6
Mississippi				271.5
<b>West South Central</b>	119.8	15.06	16.02	2,497.1
Arkansas				236.8
Louisiana				502.9
Oklahoma				360.0
Texas				1,397.4
<b>Mountain</b>	120.2	10.26	10.70	1,158.7
Montana				647.9
Idaho				98.5
Wyoming				57.7
Colorado				327.1
New Mexico				115.7
Arizona				262.3
Utah				88.9
Nevada				117.6
<b>Pacific</b>	123.4	10.80	10.49	3,481.6
Washington				345.7
Oregon				349.9
California				2,657.0
Alaska				399.6
Hawaii				78.3

<sup>1</sup>Per capita sales by State is included in Table 2 (Chapter 2).

<sup>2</sup>Weighted by total cigarette consumption.

Source: ACIR staff compilation from data in Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol. 10, Table 7, p. 12; Table 10, p. 19; Table 11, p. 22.

Table A-3  
Retail Price of Cigarettes by State  
(As of November 1, 1975)

State	Weighted Average Price per Pack	State and Federal Cigarette Taxes per Pack	Retail Price Less State and Federal Taxes
Alabama	50.4c	20.0c	30.4c
Alaska	48.3	16.0	32.3
Arizona	49.1	21.0	28.1
Arkansas	50.9	25.75	25.15
California	48.3	18.0	30.3
Colorado	44.8	18.0	26.8
Connecticut	57.6	29.0	28.6
Delaware	50.1	22.0	27.9
District of Columbia	47.8	14.0	33.8
Florida	55.9	25.0	30.9
Georgia	47.9	20.0	27.9
Hawaii	46.6	18.0	28.6
Idaho	42.5	17.1	28.4
Illinois	48.4*	20.0	28.4
Indiana	38.7	14.0	24.7
Iowa	47.8	21.0	26.8
Kansas	46.6	19.0	27.6
Kentucky	36.0	11.0	25.0
Louisiana	48.1	19.0	29.1
Maine	49.9	24.0	25.9
Maryland	46.1	18.0	28.1
Massachusetts	57.4	29.0	28.4
Michigan	47.9	19.0	28.9
Minnesota	52.1	26.0	26.1
Mississippi	46.4	19.0	27.4
Missouri	44.7*	17.0	27.7
Montana	45.3	20.0	25.3
Nebraska	46.8	21.0	25.8
Nevada	44.9	18.0	26.9
New Hampshire	43.9	20.0	23.9
New Jersey	53.6*	27.0	26.6
New Mexico	49.5	20.0	29.5
New York	54.2*	23.0	31.2
North Carolina	35.8	10.0	25.8
North Dakota	45.9	19.0	26.9
Ohio	48.5	23.0	25.5
Oklahoma	46.4	21.0	25.4
Oregon	42.4	17.0	25.4
Pennsylvania	52.3	26.0	26.3
Rhode Island	52.2	26.0	26.2
South Carolina	41.0	14.0	27.0
South Dakota	45.0	20.0	25.0
Tennessee	48.3*	21.0	27.3
Texas	53.3	26.5	28.8
Utah	43.4	16.0	27.4
Vermont	47.1	20.0	27.1
Virginia	37.9*	10.5	27.4
Washington	53.0	24.0	29.0
West Virginia	48.4	20.0	28.4
Wisconsin	51.3	24.0	27.3
Wyoming	42.6	16.0	26.6
Average (Median) for All States	47.9c	20.0c	27.3c

\*Average prices shown here do not include cigarette taxes that are imposed by one or more municipalities in the seven States identified.  
Source: ACIR staff compilation from data in, Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol. 10, Table 13, p. 53.

Table A-3  
Retail Price of Cigarettes by State  
(As of November 1, 1965)

State	Weighted Average Price per Pack	State and Federal Cigarette Taxes per Pack	Retail Price Less State and Federal Taxes
Alabama	31.5c*	15.0c	16.5c
Alaska	34.4	16.0	18.4
Arizona	29.6	14.5	15.1
Arkansas	30.3	16.0	14.3
California	25.5*	11.0	14.5
Colorado	27.1*	13.0	14.1
Connecticut	30.1	16.0	14.1
Delaware	31.0	15.0	16.0
District of Columbia	24.1	10.0	14.1
Florida	30.0	16.0	14.0
Georgia	30.6	16.0	14.6
Hawaii	31.3	16.0	15.3
Idaho	29.8	15.0	14.8
Illinois	30.0	15.0	15.0
Indiana	28.8	14.0	14.8
Iowa	31.6	16.0	15.6
Kansas	30.5	16.0	14.5
Kentucky	24.7	10.5	14.2
Louisiana	30.0	16.0	14.0
Maine	29.6	16.0	13.6
Maryland	28.2	14.0	14.2
Massachusetts	31.0	16.0	15.0
Michigan	29.2	15.0	14.2
Minnesota	30.3	16.0	14.3
Mississippi	31.8	17.0	14.8
Missouri	26.2*	12.0	14.2
Montana	30.9	16.0	14.9
Nebraska	29.6	16.0	13.6
Nevada	29.9	15.0	14.2
New Hampshire	25.9	12.5	15.0
New Jersey	30.1*	16.0	14.1
New Mexico	30.4*	16.0	14.4
New York	34.6*	18.0	16.6
North Carolina	21.7	8.0	13.7
North Dakota	30.2	16.0	14.2
Ohio	26.3	13.0	13.3
Oklahoma	30.4	16.0	14.4
Oregon	21.9	8.0	13.9
Pennsylvania	28.8	16.0	13.8
Rhode Island	30.0	16.0	14.0
South Carolina	26.2	13.0	13.2
South Dakota	30.5	16.0	14.5
Tennessee	29.5*	15.0	14.5
Texas	33.8	19.0	14.8
Utah	30.8	16.0	14.8
Vermont	32.5	18.0	14.5
Virginia	24.7*	11.0	13.7
Washington	34.7	19.0	15.7
West Virginia	28.4	14.0	14.4
Wisconsin	32.1	18.0	14.1
Wyoming	26.5	12.0	14.5
Average (Median) for All States	30.0c	16.0c	14.0c

\*Average prices shown here do not include cigarette taxes that are imposed by one or more municipalities in the nine States identified.  
Source: ACIR staff compilation from data in, Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol. 10, Table 13, p. 58.

Table A-3 Retail Price of Cigarettes by State (As of October 1, 1960)			
State	Weighted* Average Price per Pack	State and Federal Cigarette Taxes per Pack	Retail Price Less State and Federal Taxes
Alabama	28.4¢	14.0¢	14.4¢
Alaska	29.3	13.0	16.3
Arizona	23.7	10.0	13.7
Arkansas	27.0	14.0	13.0
California	25.2	11.0	14.2
Colorado	20.9	8.0	12.9
Connecticut	24.1	11.0	13.1
Delaware	24.6	11.0	13.6
District of Columbia	23.3	10.0	13.3
Florida	25.7	13.0	12.7
Georgia	26.7	13.0	13.7
Hawaii	26.3	11.9	14.4
Idaho	26.3	13.0	13.3
Illinois	25.9	11.0	14.9
Indiana	24.2	11.0	13.2
Iowa	25.4	12.0	13.4
Kansas	24.8	12.0	12.8
Kentucky	23.8	10.5	13.3
Louisiana	30.3	16.0	14.3
Maine	26.4	13.0	13.4
Maryland	24.9	11.0	13.9
Massachusetts	27.7	14.0	13.7
Michigan	27.7	14.0	13.7
Minnesota	26.6	13.5	13.1
Mississippi	26.9	14.0	12.9
Missouri	23.2	10.0	13.2
Montana	30.2	16.0	14.2
Nebraska	25.5	12.0	13.5
Nevada	25.9	11.0	14.9
New Hampshire	24.0	11.5	12.5
New Jersey	26.3	13.0	13.3
New Mexico	26.9	13.0	13.9
New York	25.8	13.0	12.8
North Carolina	20.6	8.0	12.6
North Dakota	27.0	14.0	13.0
Ohio	26.0	13.0	13.0
Oklahoma	26.1	13.0	13.1
Oregon	20.6	8.0	12.6
Pennsylvania	26.8	14.0	12.8
Rhode Island	26.6	14.0	12.6
South Carolina	26.3	13.0	13.3
South Dakota	26.8	13.0	13.8
Tennessee	26.1	13.0	13.1
Texas	28.7	16.0	12.7
Utah	26.2	12.0	14.2
Vermont	27.4	15.0	12.4
Virginia	24.5	11.0	13.5
Washington	28.5	14.0	14.5
West Virginia	26.2	13.0	13.2
Wisconsin	25.8	13.0	12.8
Wyoming	25.6	12.0	13.6
Average (Median) for All States	26.1¢	13.0¢	13.1¢

\*Prices do not include municipal cigarette taxes.  
Source: ACIR staff compilation from data in, Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol. 10, Table 13, p. 68.

Table A-4 Per Capita Sales by Tax Rate, FY 1975				
Tax Rate (Cents)	Tax Paid Sales (in Millions of Packs)	State Population (in Thousands)	Per Capita Sales (in Packs)	Percent of U.S. Average
2-6¢	4,664.6	26,757	174.4	133.2%
8-12	10,110.4	78,530	128.8	98.4
13-15	5,416.0	43,925	123.3	94.2
16+	7,474.3	63,912	117.0	89.4

Source: ACIR staff compilation from data in, Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol 10, Table 10, p. 19; Table 11, p. 22; and U.S. Bureau of the Census, *Population Estimates and Projections* (Washington, D.C.: Government Printing Office, January 1976).

Table A-5 Reservation Indian Population (States with Greater Than 1 Percent)		Percent of State Population
Alaska		18.8%
New Mexico		7.6
Arizona		6.5
South Dakota		4.5
Montana		3.3
Oklahoma		3.2
North Dakota		2.3
Nebraska		1.7
Wyoming		1.3
Nevada		1.0

Source: Taylor, Theodore W., *The States and Their Indian Citizens* (U.S. Department of Interior, Bureau of Indian Affairs: Government Printing Office, 1972) Appendix D.

Table A-6  
Estimated Tax Loss Due to Exemption of  
Tobacco Sales on Military Bases, FY 1973

	Tobacco Tax Loss (In Thousands)	Percent of Gross Cigarette and Other Tobacco Taxes
Alabama	\$ 3,949	8.7%
Alaska	896	27.4
Arizona	768	3.0
Arkansas	1,383	3.5
California	22,583	8.9
Colorado	2,703	8.3
Connecticut	1,731	2.5
Delaware	590	4.8
District of Columbia	1,731	2.5
Florida	13,751	8.4
Georgia	5,425	7.9
Hawaii	1,993	28.0
Idaho	227	2.5
Illinois	3,281	2.0
Indiana	344	0.7
Iowa	—	—
Kansas	1,533	5.3
Kentucky	582	2.9
Louisiana	2,328	4.4
Maine	843	4.2
Maryland	1,389	4.2
Massachusetts	3,458	3.1
Michigan	1,045	0.8
Minnesota	282	0.4
Mississippi	1,688	6.7
Missouri	1,226	2.2
Montana	397	3.8
Nebraska	1,088	5.1
Nevada	619	5.9
New Hampshire	504	2.0
New Jersey	5,248	3.1
New Mexico	1,453	11.6
New York	3,931	1.2
North Carolina	881	3.7
North Dakota	686	8.8
Ohio	1,811	0.9
Oklahoma	2,348	5.1
Oregon	50	—
Pennsylvania	2,418	1.0
Rhode Island	1,603	8.7
South Carolina	2,221	10.1
South Dakota	385	4.6
Tennessee	1,201	2.0
Texas	19,344	7.9
Utah	390	5.8
Vermont	9	—
Virginia	1,693	9.9
Washington	5,802	11.0
Wisconsin	280	0.4
Wyoming	184	4.7
<b>U.S. TOTAL</b>	<b>\$130,242</b>	<b>4.1%</b>

Source: ACIR, *State Taxation of Military Incomes and Store Sales* (Washington, D.C.: Government Printing Office, July 1976) pp. 14-15.

Table A-7  
Summary of State Unfair Sales Laws  
(All Data as of January 1, 1975)

	Unfair Cigarette Sales	Unfair Sales	Unfair Practices
Alabama	X		
Arizona		X	
Arkansas			X
California			X
Colorado	X		
Connecticut	X		
Delaware	X		
Georgia	X		
Hawaii		X	
Idaho		X	
Indiana	X		
Iowa	X		
Kentucky	X		
Louisiana		X	
Maine		X	
Maryland		X	
Massachusetts	X		
Michigan		X	X
Minnesota	X		
Mississippi	X		Xa
Missouri			X
Montana	X		
New Hampshire		X	
New Jersey	X		X
New Mexico	X		
North Dakota			X
Ohio	X		
Oklahoma	X	X	
Oregon		X	X
Pennsylvania	X	X	
Rhode Island			X
South Carolina			
South Dakota	X		
Tennessee	X	X	
Texas		X	
Utah		X	
Virginia		X	
Washington	X		X
West Virginia	X	X	
Wisconsin		X	
Wyoming			X

<sup>a</sup> Applies to milk only.

<sup>b</sup> Applies only to grocery stores.

Note: Violation of these laws is generally a misdemeanor. The penalty is normally a small fine of up to \$1,000 or imprisonment for a short term in about a dozen States. The minimum markup allowed is cost or a specific percentage ranging from 2 to 5 percent for wholesalers and 6 to 12.4 percent for retailers.

Source: National Association of Tobacco Dealers, *NATD Coordinator*, (New York, N.Y.: 1975).

Table A-8  
Selected 1976 Cigarette Tax Data

State	Tax Paid Per Capita Sales (In Packs)	Gross Cigarette Tax Collections <sup>1</sup> (In Millions)	Local Gross Cigarette Tax Collections <sup>1</sup> (In Millions)	Weighted Average Price per Pack <sup>2</sup> (In Cents)
Alabama	116.2	\$ 50.4	\$ 9.7	50.1c
Alaska	164.8	4.6	—	51.5
Arizona	122.3	35.3	—	48.7
Arkansas	119.1	44.7	—	52.6
California	128.0	271.2	—	49.0
Colorado	134.2	33.9	—	44.7
Connecticut	113.4	73.7	—	58.4
Delaware	153.0	12.4	—	51.7
District of Columbia	167.7	10.1	—	51.9
Florida	130.3	185.1	—	55.9
Georgia	125.9	74.4	—	49.5
Hawaii	99.4	8.6	—	49.4
Idaho	125.1	9.3	—	45.6
Illinois	134.4	178.9	18.1	49.4
Indiana	166.6	53.1	—	40.6
Iowa	124.4	46.5	—	49.4
Kansas	127.7	32.1	—	48.1
Kentucky	230.9	23.5	—	36.9
Louisiana	139.6	58.2	—	48.9
Maine	144.9	24.5	—	50.9
Maryland	137.1	56.2	—	49.2
Massachusetts	116.9	143.1	—	57.3
Michigan	138.0	139.0	—	48.3
Minnesota	116.7	82.5	—	53.1
Mississippi	120.9	31.2	—	48.8
Missouri	139.5	59.8	19.9	45.9
Montana	124.9	11.2	—	47.6
Nebraska	118.1	23.7	—	48.1
Nevada	201.4	11.8	—	49.3
New Hampshire	290.5	28.5	—	45.0
New Jersey	122.4	170.1	0.2	56.9
New Mexico	102.4	14.1	—	51.6
New York	124.6	338.7	51.0	53.8
North Carolina	230.2	25.1	—	36.6
North Dakota	125.4	8.8	—	47.4
Ohio	124.6	201.1	—	49.8
Oklahoma	138.6	48.9	—	47.9
Oregon	156.5	32.2	—	44.4
Pennsylvania	118.8	253.0	—	53.3
Rhode Island	150.2	25.4	—	52.3
South Carolina	136.8	23.2	—	42.2
South Dakota	116.7	9.6	—	46.4
Tennessee	121.7	66.3	1.0	49.6
Texas	121.4	273.2	—	53.3
Utah	77.9	7.5	—	44.7
Vermont	171.1	9.7	—	47.0
Virginia	158.1	19.6	13.7	38.4
Washington	100.3	56.9	—	53.7
Virginia	129.7	28.1	—	48.9
Wisconsin	115.4	85.0	—	52.1
Wyoming	161.5	4.8	—	43.4
U.S. TOTAL	133.2 <sup>3</sup>	\$3,518.8	\$113.6	49.2c <sup>4</sup>

<sup>1</sup>Fiscal year ending June 30.

<sup>2</sup>As of November 1, 1976.

<sup>3</sup>Weighted average of all taxing States.

<sup>4</sup>Median for all States.

Source: ACRJ staff compilation from data in, Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1976) Vol. 11, Table 8, p. 13; Table 11, p. 22; Table 13, p. 71; Table 16, p. 106.

Appendix B

Description of Statistical Methodology  
Used to Estimate Cigarette Sales and  
Revenue Impact of Cigarette Bootlegging

Estimating Cigarette Sales

The method used to estimate cigarette sales is cross-section, multiple regression analysis. A supply-demand model was postulated to explain State per capita sales. The following simplifying assumption was made; the supply of in-State (i.e., tax paid within the State) cigarettes was assumed to be perfectly elastic at the prevailing price within the State. This assumption is either explicitly or implicitly present in most studies of cigarette demand. Consequently, the per capita sales, of in-State cigarettes equals the quantity demanded. The reduced form equation becomes the demand function for in-State cigarettes:

$$Q_i = b_0 + b_1 X_{i1} + b_2 X_{i2} + \dots + b_{10} X_{i10} + u_i, i = 1 \dots 50$$

where  $Q_i$  is the per capita sales of in-State cigarettes in States  $i$ ;  $X_{i1} \dots X_{i10}$  are the values for the determinants of demand for State  $i$ ;  $b_0 \dots b_{10}$  are the parameters to be estimated; and  $u_i$  is the error term. The demand equation is assumed to be linear in the  $X$  variables, with the normal distribution assumptions and the independence of the error term also asserted.

The independent variables tested consist of the following:

- $X_1$  = State tax per pack, including both cigarette and sales taxes applied at the State level.
- $X_2$  = local tax per pack (a weighted average of all local cigarette taxes within the State, excluding local sales taxes).
- $X_3$  = per capita income.
- $X_4$  = index of tourism.
- $X_5$  = percent of population above the age of 18 years.
- $X_6$  = index of border State price differentials.
- $X_7$  = index of religion.
- $X_8$  = (binary variable) = 1 in western States, and = 0 in eastern States.
- $X_9$  = (binary variable) = 1 in lowest price State in North-east, and = 0 in all other States.
- $X_{10}$  = (binary variable) = 1 in lowest price State(s) in South, and = 0 in all other States.

The State tax per pack,  $X_1$ , was used as a proxy for the price of in-State cigarettes. It is

expected that  $b_1 < 0$ , implying that people buy less in-State cigarettes if the tax rate is high. Likewise, the local tax,  $X_2$ , was used as a proxy for the local price, and it is postulated that  $b_2 < 0$ .

If cigarettes are normal goods, per capita income,  $X_3$ , should be positively related to per capita sales; hence  $b_3$  should be positive;  $b_3 > 0$ .

To measure the effect of tourism on per capita sales, per capita hotel and motel receipts were used as the index of tourism,  $X_4$ . It is expected that  $b_4 > 0$ .

The percent of population over 18 years of age,  $X_5$ , was also assumed to be positively related to per capita sales;  $b_5 > 0$ .

The index of price differentials,  $X_6$ , ideally represents the demand for in-State cigarettes, which is derived from populations in border States, and vice versa. Cigarettes from other States here are considered to be substitute goods; hence the index of the price of these substitutes should be positively related to per capita sales of in-State cigarettes;  $b_6 > 0$ .

This index was constructed by weighting the differences in prices by the relative populations of the States in question.<sup>1</sup> If the border State price was higher than the base State price, the difference was weighted by the ratio of the border State population divided by the base State population. If the price in the border State was lower than in the base State, the price difference was weighted by the ratio of the base State population divided by the base State population, which is, in effect, the same as using an unweighted price difference. The logic of this approach is that if the price in the border State is higher, the size of the population of that State can affect the level of sales in the base State. However, if the price in the border State is lower, the population is irrelevant because residents of the base State will be making cigarette purchases in the border State and population of the border State has no bearing on the effect of these purchases on cigarette sales in the base State.

The formula used was  $X_6 = (Pdh - Pdl)$  where:

$$Pdh = \sum_{j=1}^K \frac{(P_j - P) (\text{population of border State})}{\text{population of base State}}$$

$K$  = number of higher price bordering States.

$P_j$  = price in  $j$ th higher price bordering State.

$P$  = price in the base State.

$$Pdl = \sum_{i=1}^n \frac{(P - P_i) (\text{population of base State})}{\text{population of base State}}$$

$n$  = number of lower price bordering States.

$P_i$  = price in the  $i$ th lower price bordering State.

Only in a very crude fashion does this index take into account the availability of bootleg cigarettes, however, because it implicitly assumes that the potential market for a State's cigarettes is made up of the entire population of the border States, with little or no account for the distance of populations from the border.

This formula is adopted from a price differential index used by Alexander Wiseman in his doctoral dissertation concerning the demand for cigarettes.<sup>2</sup> Wiseman used the price differential weighted by the population in counties within 40 miles of the border. This is a superior technique to the method described above because it considers population concentrations, which are important factors in across-border smuggling, particularly casual smuggling. However, calculating this type of index for all States is extremely time consuming and is beyond the scope of this report. But this calculation is quite feasible for tax estimators in a single State who are attempting to develop cigarette tax revenue estimates. As will be explained below, this variable was significant in the cross-section analysis. It probably would be significant in a time-series analysis for many States and should be used as a variable in a State cigarette sales equation.

Again following the work of Wiseman, a religion index was constructed to account for religious opposition to smoking:  $X_7$  equals the percent of State population adhering to the Church of the Latter Day Saints (the Mormon belief) plus the percent belonging to the Seventh Day Adventists. The States with a high index are: Utah (74.6 percent), Idaho (27.8 percent), Nevada (9.9 percent), Wyoming (9.3 percent), and Arizona (6.3 percent). For the United States as a whole, 1.3 percent of the population

adhere to these religions. The expected sign for  $b_7$  is negative, because these groups disapprove of smoking;  $b_7 < 0$ .

Regional dummy variables allow for what is expected to be different habits, tastes, and preferences for smoking in different regions. As indicated in Table 18 (Chapter 7), people in the West and North Central regions tend to smoke less than people in eastern States. The States west of Missouri and north of Texas were classified as western States, and all other States as eastern States. This classification allows one to postulate an inverse relationship between  $X_8$  (equalling 1 for western States and zero for eastern States) and per capita sales;  $b_8 < 0$ .

The inclusion of the last two variables,  $X_9$  and  $X_{10}$ , represents an attempt to inject an interstate bootlegging dimension into the model. Previous cross-section studies considered only border State bootlegging, possibly because the interstate problem was believed to be minimal or nonexistent at the time. In recent years, however, there is ample evidence to show that interstate bootlegging has escalated to unprecedented levels, and as such, this aspect of demand should be included in the specification of the model.

This study assumes that only the lowest price State in a region where interstate bootlegging is present is likely to benefit from this kind of demand. The amount of gain in per capita sales depends, of course, on the population of the low-price State, the population of the high-price State, the price differential, the distance between the States, and the risk factor involved in the transportation of the contraband cigarettes. To avoid this complexity, two simple intercept dummy variables were used to account for the windfall gains received by the lowest price State in the two regions most affected by interstate smuggling.

In the Northeast, New Hampshire was the lowest price State. Interstate bootlegging, in this case, could be casual to a great extent because of the large tourist flows through the State. This type of tourism is not picked up by the hotel and motel receipts variable, nor should it be, because this pass-through type of situation is essentially a casual smuggling problem, different from the kind of tourism in Florida, Nevada, and other States where tour-

ists stay for long periods and consume cigarettes while in the State. The New Hampshire smuggling problem is also understated by the border State tax differential index, because the States of New York and Connecticut are not considered to border New Hampshire, although they are certainly close enough to make smuggling profitable. For these reasons, it is believed that New Hampshire has a unique type of interstate smuggling problem which must be handled via the binary variable  $X_9$ .

In the case of the rest of the Eastern region, two States stand out in the Battelle-LEAA survey of cigarette bootlegging as the most cited sources of interstate contraband—North Carolina and Kentucky. Cigarettes from these two States have been found in States as far removed as Massachusetts, Minnesota, Texas, and Florida. The major source of New York's bootleg cigarettes is most probably these two States. Variable  $X_{10}$  is meant to handle this important interstate smuggling phenomenon, taking on the value of 1 for each of the two States—Kentucky and North Carolina—and zero for the remaining States. The expected sign for both  $b_9$  and  $b_{10}$  is positive because interstate smuggling concentrated around these particular States should have the effect of shifting upward the demand for cigarettes in these States;  $b_9 > 0$ ;  $b_{10} > 0$ .

### Results of the Regression

Per capita cigarette sales for 1975 were regressed on  $X_1$  through  $X_{10}$ . The estimated coefficients  $b_1$  through  $b_{10}$ , along with the  $t$ -statistics (in parentheses) are shown in Table B-1.

From a simple statistical standpoint, the results appear to be satisfactory because (1) the  $R$ -squared was relatively high, (2) all the estimated coefficients had their hypothesized signs, and (3) they were all significant to the standard 95 percent confidence level. It should be noted, however, that the significance of these variables is not coincidental. Some variables that were tried, such as the percent of population on Indian reservations and population density, had either the wrong sign or were insignificant. Because these variables were not deemed essential from a theoretical point of view, they were omitted for simplicity. Other variables, such as the urban-rural and male-female ratios,



Table B-1  
Results of Regression

Variable	Estimated Coefficient	t Statistic
State Tax	$b_1 = -3.63867$	(-9.77)
Local Tax	$b_2 = -5.51998$	(-2.65)
Per Capita Income	$b_3 = 0.00569$	( 4.23)
Tourism	$b_4 = 0.05355$	( 8.34)
Age	$b_5 = 2.40989$	( 3.59)
Price Differential	$b_6 = 0.50338$	( 2.75)
Religion	$b_7 = -0.50978$	(-4.21)
Regional Dummy	$b_8 = -12.26431$	(-4.52)
New Hampshire Dummy	$b_9 = 120.88257$	(14.79)
Kentucky-North Carolina Dummy	$b_{10} = 60.26431$	( 8.70)

$R^2 = 0.958$  (0.949 when adjusted for degrees of freedom)  
 $b_0 = -16.3$  (the intercept term)

Source: Computed by ACIR staff.

also were excluded for simplicity reasons, based on previous studies, although they may still have some theoretical impact and otherwise ought to be included. Some variables actually included were tried in more than one form, with the most "significant" form chosen for the final form. This was the case with both the religion index and the population age variable. The other hypothesized forms tried were  $X_5^*$ , the percent of population between the ages of 18 and 44, and  $X_7^*$ , the percent of population adhering to some (any) religion.

Finally, it should be noted that the dummy variables,  $X_9$  and  $X_{10}$ , were quite important in raising the R-squared. This would occur to some extent whether or not the variables were justified theoretically. In this case, however, the theoretical justification is backed up by evidence of interstate bootlegging, and leaving out such variables would give rise to poor estimates that are biased and possibly insignificant. To give some indication of the importance of these two variables in the estimation of cigarette demand, the regression was estimated without these interstate dummy variables. The resulting R-squared was only 0.674 (0.619 after adjusting for degrees of freedom). Every t-statistic declined in absolute value, and three variables—religion, price differential, and per capita income—were no longer statistically significant.

A more detailed comparison of estimating per capita sales with and without the two interstate dummy variables is shown in Table B-2. It is observed that for 33 of the 50 States, estimates making use of the interstate factors  $X_9$  and  $X_{10}$  are superior to estimates that ignore these factors. Moreover, the estimates of Kentucky, North Carolina, and New Hampshire sales are clearly out of line when the interstate factors are not considered, underscoring the fact that the model is misspecified as long as they are not explicitly considered as sources of interstate bootlegging.

Another measure of the relative importance of these variables in explaining per capita sales is the beta weight or beta coefficient computed for each regression coefficient. The variables related to interstate smuggling— $X_1$ ,  $X_9$ , and  $X_{10}$ —had the largest beta weights. ( $X_1$  is related to interstate smuggling because the higher a State's tax, the more likely the State is to lose in per capita sales via interstate smuggling.) It should also be noted that the border State price differential variable,  $X_6$ , had a considerably reduced beta weight when variables  $X_9$  and  $X_{10}$  were included.

In summary, bootlegging variables are important in explaining the per capita sales variation among the States. This outcome was to be expected from the widespread evidence of cigarette smuggling. Somewhat unexpected-

Table B-2  
1975 Per Capita Cigarette Sales<sup>1</sup>

States	Actual Sales (In Packs)	Estimated With Interstate Smuggling Variables (In Packs)	Estimated Without Interstate Smuggling Variables (In Packs)
Alabama	111.7	114.5	114.7
Alaska	150.4	146.7	139.5
Arizona	121.8	108.4	101.8
Arkansas	114.8	109.3	111.8
California	127.1	130.9	129.0
Colorado	131.0	136.0	140.0
Connecticut	110.2	116.3	108.4
Delaware	147.6	142.5	149.5
District of Columbia	176.5	175.9	189.9
Florida	131.9	122.3	121.6
Georgia	122.9	128.4	137.4
Hawaii	NA	NA	NA
Idaho	123.3	126.1	131.7
Illinois	131.8	130.8	127.0
Indiana	162.4	157.5	179.4
Iowa	120.5	130.5	135.8
Kansas	123.4	128.1	128.5
Kentucky	223.0	224.3	194.8
Louisiana	133.6	123.7	132.3
Maine	140.7	120.7	126.0
Maryland	146.1	143.9	153.2
Massachusetts	126.1	130.9	134.1
Michigan	136.8	134.5	140.1
Minnesota	111.5	116.0	114.0
Mississippi	116.8	117.9	127.9
Missouri	135.6	132.8	132.5
Montana	123.7	122.2	122.4
Nebraska	114.1	122.8	119.0
Nevada	205.2	208.0	208.5
New Hampshire	269.1	269.1	165.7
New Jersey	122.3	121.9	118.0
New Mexico	103.1	104.6	101.3
New York	123.9	120.4	109.0
North Carolina	226.0	224.7	194.1
North Dakota	117.9	123.5	122.3
Ohio	122.5	127.8	131.7
Oklahoma	132.9	124.0	127.9
Oregon	154.4	144.4	155.8
Pennsylvania	114.6	123.4	124.5
Rhode Island	154.7	143.8	156.3
South Carolina	130.5	143.0	162.7
South Dakota	113.5	123.6	127.2
Tennessee	117.4	121.7	127.8
Texas	116.0	110.0	107.2
Utah	75.8	78.3	77.5
Vermont	155.5	159.6	185.5
Virginia	152.7	159.3	175.1
Washington	99.5	104.4	90.9
West Virginia	123.2	129.3	140.1
Wisconsin	113.5	115.6	114.4
Wyoming	160.7	146.1	154.1

<sup>1</sup>In packs per capita  
Source: Computed by the ACIR staff.

ly, the interstate smuggling variables,  $X_9$  and  $X_{10}$ , turned out to be relatively important when compared to the border State price differential variable  $X_8$ . The social and demographic variables, especially tourism and religion, were also important factors in estimating cigarette sales in a number of States.

#### Estimates of Gains and Losses From Cigarette Bootlegging

The results of the regression analysis of cigarette demand were used to estimate gains and losses from cigarette bootlegging by the following method. The total variation in per capita sales was assumed to originate from two basic sources: smuggling and nonsmuggling factors. The per capita sales figures in Table B-3, column 1, were estimated using all the variables and regression coefficients obtained in the previous analysis. Hypothetical per capita sales figures were then estimated by varying only the factors unrelated to bootlegging and multiplying, for each State, these variables by the regression coefficients obtained earlier. Every State was assumed to be uniform with respect to smuggling factors; hence, the hypothetical per capita sales figures vary from one State to another only as a result of the variation in nonsmuggling factors. These hypothetical per capita sales estimates, displayed in column 2 of Table B-3, therefore represent the per capita sales that would have resulted if no bootlegging had occurred. Subtracting column 2 from column 1 gives the estimated per capita sales gain or loss resulting from bootlegging (column 3).

This procedure for estimating gains and losses from cigarette smuggling depends on the division of the explanatory variables into two distinct groups—those affecting smuggling, and those not affecting smuggling. The first group is made up of the price differential ( $X_8$ ), the interstate smuggling dummy variables ( $X_9$  and  $X_{10}$ ), and the State and local tax on cigarettes ( $X_1$  and  $X_2$ ). The second group contains per capita income ( $X_3$ ), tourism ( $X_4$ ), age ( $X_5$ ), religion ( $X_7$ ), region ( $X_6$ ), and the State and local tax ( $X_1$  and  $X_2$ ).

Because the State and local tax variables were present in both groups, some means had to be devised to separate the consumption

effect of the tax from the bootlegging effect. For this purpose, the State and local tax variables were replaced by retail price (including tax) and the regression was reestimated. The coefficient obtained for price was -2.44. Wiseman estimated the price elasticity of demand to be between -0.26 and -0.38. A previous study by Lyon and Simon<sup>3</sup> produced a range of -0.34 to -0.71. An elasticity of -0.34 was chosen to conform to these two estimates.<sup>4</sup> Substituting into the elasticity formula,

$$E_d = \frac{\Delta Q}{\Delta P} \cdot \frac{P}{Q}$$

where  $E_d$  equals -0.34,  $P$  equals average price (47.5 cents), and  $Q$  equals average per capita sales (136.4 packs), resulted in:

$$\frac{\Delta Q}{\Delta P} = -0.98$$

which is the expected coefficient of the price variable representing the consumption effect alone. The coefficient actually obtained from the regression was -2.44. Thus, about 40 percent of the change in per capita sales due to a change in price is the result of the consumption effect. The remaining 60 percent was assumed to be the result of bootlegging. It seemed plausible to assume this 40-60 ratio also held for the change in per capita sales due to the change in the tax rate. Thus, 40 percent of the variation in  $X_1$  and  $X_2$  was included in calculating the hypothetical per capita sales figures in Table B-3, column 2.

These per capita figures were multiplied by the population and the State and local tax per pack in each State in 1975 to obtain the revenue estimates in Table 19 (Chapter 7). The local tax rate is an average for the State as a whole. Only seven States had local cigarette taxes (the local sales tax was not included in this study). These States, their local cigarette tax rates, and the estimated revenue are shown in Table B-4 (New Jersey is excluded because the weighted local tax rate is insignificant). It was assumed that local per capita sales were identical to that of the State. This assumption leads to underestimation of local revenue losses, because one would expect per capita sales to be lower due to more bootlegging in cities with local cigarette

Table B-3  
Estimated Per Capita Gains and Losses<sup>1</sup>  
(Based on 1975 Data)

	1	2	3
	Estimated Per Capita Sales	Hypothetical Per Capita Sales (If No Smuggling Occurs)	Per Capita Gain or Loss (1-2)
Alabama	114.5	126.8	-12.3
Alaska	146.7	141.0	5.7
Arizona	108.4	118.4	-10.0
Arkansas	109.3	126.6	-17.3
California	130.9	136.7	- 5.8
Colorado	136.0	134.7	1.3
Connecticut	116.3	139.5	-23.2
Delaware	142.5	144.9	- 2.4
District of Columbia	175.9	173.1	2.8
Florida	122.3	143.6	-21.3
Georgia	128.4	133.8	- 5.4
Hawaii	NA	NA	NA
Idaho	126.1	122.6	3.5
Illinois	130.8	143.6	-12.8
Indiana	157.5	146.9	10.6
Iowa	130.5	139.8	- 9.3
Kansas	128.1	133.6	- 5.5
Kentucky	224.3	145.8	78.5
Louisiana	123.7	128.0	- 4.3
Maine	120.7	132.9	-12.2
Maryland	143.9	143.4	0.5
Massachusetts	130.9	143.9	-13.0
Michigan	134.5	140.3	- 5.8
Minnesota	116.0	133.2	-17.2
Mississippi	117.9	122.3	- 4.4
Missouri	132.8	140.8	- 8.0
Montana	122.2	125.7	- 3.5
Nebraska	122.8	130.6	- 7.8
Nevada	208.0	201.9	6.1
New Hampshire	269.1	143.5	125.6
New Jersey	121.9	140.6	-18.7
New Mexico	104.6	110.5	- 5.9
New York	120.4	141.4	-21.0
North Carolina	224.7	148.8	75.9
North Dakota	123.5	126.7	- 3.2
Ohio	127.8	138.3	-10.5
Oklahoma	124.0	127.5	- 3.5
Oregon	144.4	137.1	7.3
Pennsylvania	123.4	140.1	-16.7
Rhode Island	143.8	146.4	- 2.6
South Carolina	143.0	137.1	5.9
South Dakota	123.6	124.6	- 1.0
Tennessee	121.7	133.9	-12.2
Texas	110.0	129.0	-19.0
Utah	78.3	76.3	2.0
Vermont	159.6	141.6	18.0
Virginia	159.3	151.4	7.9
Washington	104.4	124.0	-19.6
West Virginia	129.3	136.8	- 7.5
Wisconsin	115.6	132.1	-16.5
Wyoming	146.1	138.4	7.7

<sup>1</sup>In packs per capita.  
Source: Computed by the ACIR staff.

taxes than in the rest of the State. The usefulness of these local revenue figures therefore is severely limited. The data is provided only for the purpose of separating State revenue estimates from total State and local revenues, which were given previously in Table 19 (Chapter 7).

A word of caution is in order concerning these estimates. The gains and losses presented in Table B-3, column 3, depend to a large degree on the assumed price elasticity, -0.34.

The sensitivity of estimated gains and losses to the selection of the elasticity parameter (the consumption effect) is shown in Table B-5, in which gains and losses under three different elasticity values are compared. An argument can be made that consumption is more elastic (-0.68) now than 10 years ago because of the considerable rise in cigarette prices and taxes in recent years. The counter argument claims that although prices and taxes have risen, aggregate per capita consumption has also risen, suggesting, if anything, that consumption is very inelastic (-0.00). In the absence of conclusive evidence one way or another, the chosen elasticity (-0.34) remains plausible. Moreover, the gains and losses could have been measured as the difference between the hypothetical and the actual per capita sales, as opposed to the difference between the hypothetical and the estimated per capita

sales. Other facets of the analysis, such as the crude price differential variable and the dummy variable incorporation of interstate smuggling factors, make these estimates subject to an uncertain degree of error.

#### The Impact of Cigarette Bootlegging on State Cigarette Revenue Estimates

The first part of this appendix discussed the prime determinants of cigarette sales and how they are used in a cross-section analysis to estimate tax revenues and revenues lost because of smuggling activity. These determinants can also be used in a time-series analysis to estimate cigarette sales in an individual State. If a State is not subject to a significant level of cigarette smuggling, the analysis is relatively straightforward and a large proportion of the variance in cigarette sales can be explained by traditional variables, such as population, income, and price.

To illustrate the methodology used to estimate State cigarette sales, California was chosen as a test State because there appears to be little bootlegging activity and per capita sales are close to the national average (2.9 percent below the national average). California does have a tax evasion problem because of the tax-free sale of cigarettes at military establish-

Table B-4  
Local Cigarette Tax Revenues  
(Based on 1975 Data)

States <sup>1</sup>	1 Local Cigarette Tax <sup>2</sup> (cents/pack)	2 Estimated Local Cigarette Revenues (in millions)	3 Hypothetical Local Cigarette Revenues (in millions)	4 Gain or Loss (in millions)
Alabama	1.5	\$6.1	\$6.8	-\$0.7
Illinois	1.2	17.5	19.2	- 1.6
Missouri	2.9	18.3	19.4	- 1.1
New York	2.0	43.6	51.0	- 7.4
Tennessee	0.2	1.0	1.1	- 0.1
Virginia	1.7	13.4	12.7	0.7

<sup>1</sup>New Jersey's local tax was considered negligible.

<sup>2</sup>Local rate given is average for entire State.

Source: Computed by the ACIR staff.

Table B-5  
Estimated Gains and Losses<sup>1</sup> Under Three Elasticity Assumptions,  
Parametric Sensitivity  
(In Millions)

State	Gain or Loss (E <sub>d</sub> = 0.00 <sup>2</sup> )	Gain or Loss (E <sub>d</sub> = 0.34)	Gain or Loss (E <sub>d</sub> = -0.68)
Alabama	\$ -9.3	\$ -6.9	\$ -3.4
Alaska	0.3	0.2	0.0
Arizona	-4.2	-3.4	2.0
Arkansas	-8.9	-6.5	-3.4
California	-14.5	-16.0	-11.8
Colorado	1.5	0.3	-0.4
Connecticut	-22.3	-15.1	-6.6
Delaware	-0.3	-0.2	0.0
District of Columbia	0.6	0.2	-0.1
Florida	-51.9	-35.7	-16.3
Georgia	-2.6	-2.8	-1.9
Hawaii	NA	NA	NA
Idaho	0.7	0.3	1.3
Illinois	-27.7	-21.7	-12.2
Indiana	7.4	4.0	1.3
Iowa	-5.1	-4.0	-2.1
Kansas	-1.4	-1.6	-1.2
Kentucky	15.4	13.3	19.2
Louisiana	-1.8	-2.1	-1.4
Maine	2.8	-2.1	-1.1
Maryland	-0.2	0.2	-1.2
Massachusetts	-15.7	-12.1	-6.6
Michigan	-6.3	-6.9	-5.1
Minnesota	-16.9	-12.2	-6.0
Mississippi	-1.1	-1.3	-0.8
Missouri	-5.9	-5.0	-2.8
Montana	-0.1	-0.3	-0.3
Nebraska	-2.0	-1.7	-1.1
Nevada	0.6	0.4	0.3
New Hampshire	11.6	11.3	11.2
New Jersey	-37.4	-26.0	-11.7
New Mexico	-1.1	-1.0	-0.5
New York	-105.7	-72.3	-32.1
North Carolina	19.5	16.6	14.0
North Dakota	-0.1	-0.2	-0.1
Ohio	-20.8	-16.9	-10.1
Oklahoma	-1.0	-1.2	-0.7
Oregon	2.8	1.5	0.6
Pennsylvania	-50.1	-35.6	-17.1
Rhode Island	-0.3	0.3	-0.1
South Carolina	3.1	1.4	0.0
South Dakota	0.0	-0.1	-0.1
Tennessee	-9.5	-7.8	-4.7
Texas	-58.3	-43.1	-20.0
Utah	0.9	0.3	-0.1
Vermont	1.2	1.0	1.0
Virginia	5.3	2.5	0.3
Washington	-18.7	-13.2	-6.2
West Virginia	-2.2	-1.9	-1.1
Wisconsin	-19.4	-13.6	-6.4
Wyoming	0.5	0.2	0.1
<b>TOTAL (Net)</b>	<b>\$-448.6</b>	<b>\$-337.1</b>	<b>\$-144.3</b>

<sup>1</sup>Gains and losses are for 1975 total cigarette revenue including State and local cigarette tax plus State sales tax.

<sup>2</sup>This assumption was also employed for estimating revenues resulting from uniform tax credit plan in Table 12.

Source: ACIR staff computation.

ments. The recent ACIR report on military sales estimated that in 1973, California lost \$22.6 million (about 9 percent) of total cigarette tax collections because of the military tax exemption. However, this situation has persisted for a number of years and should not seriously bias a time-series analysis.

The time-series data for California was for fiscal years 1960-75. Normally more observations would be used, but California did not adopt a cigarette tax until July 1959. Additional observations can be obtained by using quarterly or semi-annual data, but that adds to the data collection problem and was not considered necessary for the purposes of this analysis. (The best choice would probably be semi-annual data, which would increase the reliability of the estimating equation and minimize the data collection problem.)

The variables used to estimate California per capita cigarette sales are: percentage of the population over 18 years of age, the real retail price, real per capita income, and a time trend. The time trend is included to account for the habitual nature of cigarette smoking. The tax rate is not included as an explanatory variable because it is included in the retail price. An alternative approach would be to use the State tax rate and the retail price less the State tax rate. A health scare dummy was used in one equation and it was not significant, although it improved the R-squared slightly. All the independent variables used in the analysis were significant and the signs were correct. The

results of the time-series analysis for California are included in Table B-6.

The estimation problem becomes more difficult in a State that has an inflow or outflow of cigarettes from other States. Kentucky is an example of a State that exports large amounts of cigarettes to other States, largely because of a low cigarette tax rate (3 cents).

A regression equation was run for Kentucky using the same variables and time period as for California. The only variable that was significant was population. The R-squared was 0.932 and the standard error was 8.14 packs or 5.5 percent of the mean.

The main element missing from the equation was a measure of the cigarette bootlegging effect in Kentucky. An attempt to measure this effect was made by using the tax differential between Kentucky and Ohio.

Ideally such a measure should be weighted by the population of all bordering counties within a certain distance of the border. This is a time consuming calculation that was not deemed necessary for this analysis but would probably be worthwhile for any State that has a significantly different tax rate than its neighbors. A detailed discussion of such a calculation is contained in the Wiseman dissertation (pp. 16-26) referred to earlier in this report.

The addition of the tax differential variable to the Kentucky estimating equation significantly improved the R-squared and reduced the standard error. However, the signs for population and income were wrong and population

Table B-6 Results of California Time-Series Analysis		
Variable	Regression Coefficient	t Value
Constant	91.110	—
Time Trend	-2.335	-7.300
Percent Population 18+	1.048	2.705
Real Price	-1.579	-8.860
Real Per Capita Personal Income	0.0104	3.047
R <sup>2</sup> = 0.969		
Standard error of the estimate = 1.530 (1.1 percent of mean)		
Source: Compiled by ACIR staff.		

Table B-7 Results of Kentucky Time-Series Analysis		
Variable	Regression Coefficient	t Value
Constant	600.047	—
Tax Differential	4.863	4.139
Real Per Capita Personal Income	-3.808	-1.022
Time Trend	4.110	.216
Population 18+	-2.963	-0.654
Real Retail Price	-8.266	-3.708
R <sup>2</sup> = 0.975		
Standard error of the estimate = 5.036 (3.4 percent of mean)		
Source: Compiled by ACIR staff.		

was no longer significant. This perhaps indicates the overshadowing importance of the differential variable in States with bootleg problems.

The coefficient for the tax differential indicates that for each 1 cent advantage Kentucky has over bordering States, per capita sales will increase 4.86 packs. This is a conservative estimate because the price variable is highly correlated with the tax differential and takes away from its estimated importance. The results of the time-series analysis are presented in Table B-7.

An attempt was also made to estimate cigarette sales in Washington, a State that loses sales to neighboring Oregon. The results using the traditional variables (time, age of population, income, and price) were very poor. The R-squared was only 0.412 and none of the variables were significant. The addition of the tax differential variable (differential between Oregon and Washington) improved the R-squared to 0.730 and reduced the error. However, only the tax differential was significant. The coefficient of the tax differential was 2.691, which indicates that sales in Washington are reduced 2.7 packs for every cent that the Washington tax exceeds the Oregon tax. Because the tax differential between Oregon and Washington is 7 cents, the effect on sales is 18.9 packs per capita. In 1975, Washington per capita sales were 24 percent below the U.S. average. If 18.9 packs were added, Washington sales would be less than 10 percent below the

U.S. average. The remaining difference, as well as the relatively low R-squared for the estimating equation, may be explained by the loss of taxable sales to Indian reservations where cigarettes are sold tax free.

In the absence of bootlegging, sales can be estimated with reasonable accuracy given traditional variables. But the existence of cigarette bootlegging distorts traditional relationships and requires the use of new, more sophisticated estimating techniques.<sup>5</sup> To develop accurate estimates of cigarette tax revenues, State revenue estimators should take into account the problem of cigarette bootlegging.

Data Sources

Per Capita Sales, State Tax, Price—Tobacco Tax Council, Inc., *The Tax Burden on Tobacco* (Richmond, Va.: 1975) Vol. 10.

Local Tax—Unpublished data from the Tobacco Tax Council, Inc.

Per Capita Income—Bureau of Economic Analysis, *Survey of Current Business* (Dept. of Commerce, Washington, D.C.: Government Printing Office, August 1976).

Tourism Index—Computed from U.S. Bureau of the Census, *1972 Census of Selected Services; Area Statistics* (Washington, D.C.: Government Printing Office, 1972) Vol. II.

Age of Population—U.S. Bureau of the Census, *Estimates of the Population of States by Age: July 1, 1974 and 1975*, Series P. 25, No. 619,

(Washington, D.C.: Government Printing Office, 1976).

Price Differential—ACIR staff compilation.  
Religion Index—Computed from Douglas W.

Johnson, Paul R. Picard, and Bernard Quinn, *Churches and Church Membership in the United States, 1971* (Washington, D.C.: Glenmary Research Center, 1974).

#### FOOTNOTES

<sup>1</sup>Price differences of 1 cent or less were ignored in the calculation of the price differential index because it was believed that such small differences would not contribute to bootlegging. Some judgment was employed in determining the set of States that border the base State. For example, Arizona and Colorado were not considered border States because the border contact is minimal and there is low population density around the point of contact.

<sup>2</sup>Alexander C. Wiseman, "The Demand for Cigarettes in the United States: Implications for State Tax Policy," doctoral dissertation, University of Washington, January

1968.

<sup>3</sup>Herbert L. Lyon and Julian L. Simon, "Price Elasticity of Demand for Cigarettes in the United States," *American Journal of Agricultural Economics*, Vol. 50, November 1968, p. 892.

<sup>4</sup>For an extensive listing of previous price elasticity estimates for cigarette demand, see Paul B. Manchester, "An Econometric Analysis of State Cigarette Taxes, Prices, and Demand, With Estimates of Tax-Induced Interstate Bootlegging," a thesis submitted to the University of Minnesota, August 1973, p. 37.

<sup>5</sup>Paul B. Manchester, "Interstate Cigarette Smuggling," *Public Finance Quarterly*, Vol. 4, No. 2, April 1976.

#### Appendix C

### Proposed Federal Legislation to Implement ACIR Recommendations With Respect to Cigarette Bootlegging

#### FEDERAL CONTRABAND LEGISLATION

##### A Bill

To eliminate racketeering in the sale and distribution of cigarettes, and  
for other purposes.

Be it enacted by the Senate and House of Representatives of the United  
States of America in Congress assembled,

#### STATEMENT OF FINDINGS AND PURPOSE

- 1 SECTION 1. (a) The Congress finds that:
- 2 (1) there is a widespread traffic in cigarettes moving in or otherwise affecting interstate or
- 3 foreign commerce, and that the States are not adequately able to stop the movement into and sale
- 4 of such cigarettes in violation of their tax laws through the exercise of their police power;
- 5 (2) there is a causal relationship between the flow of cigarettes into interstate commerce to
- 6 be sold in violation of State laws and the rise of racketeering in the United States;
- 7 (3) organized crime has realized multi-millions of dollars in profits from the sale of such
- 8 cigarettes in violation of State laws, and has channelled such profits into other illicit activities;
- 9 (4) a sharply expanded Federal role in the fight against cigarette smuggling is essential if
- 10 there is to be an effective law enforcement effort against cigarette smuggling since the interstate na-
- 11 ture of the crime places individual States at too great a disadvantage to handle these problems
- 12 effectively;
- 13 (5) certain records maintained by dealers in cigarettes will have a high degree of usefulness
- 14 in criminal, tax, and regulatory investigations.
- 15 (b) It is purpose of this act to provide a timely solution to a serious organized crime problem
- 16 and to help provide relief to many cities and States.
- 17 SECTION 2. Title 18, United States Code, is amended by inserting immediately after chapter
- 18 59 thereof the following new chapter:

## "Chapter 60. CIGARETTE TRAFFIC

## "SECTION

"1285. Definitions.

"1286. Unlawful Acts.

"1287. Recordkeeping and Reporting.

"1288. Penalties.

"1289. Effect on State Law.

"1290. Enforcement and Regulations.

"SECTION 1285. *Definitions.* As used in this chapter:

"(a) the term 'cigarette' means:

"(1) any roll of tobacco wrapped in paper or in any substance not containing tobacco, and

"(2) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in paragraph (1).

"(b) the term 'contraband cigarettes' means a quantity in excess of twenty thousand cigarettes, bearing no evidence of the payment of applicable State cigarette taxes in the State where they are found, and which are in the possession of any person other than

"(1) a person holding a permit issued pursuant to chapter 52 of title 26, United States Code, as a manufacturer of tobacco products or as an export warehouse proprietor, or a person operating a customs bonded warehouse pursuant to 19 U.S.C. 1311 or 1555, or an agent of such person;

"(2) a common or contract carrier; provided, however, that the cigarettes are designated as such on the bill of lading or freight bill;

"(3) a person licensed, or otherwise authorized by the State where the cigarettes are found, to deal in cigarettes and to account for and pay applicable cigarette taxes imposed by such State; or

"(4) an officer, employee, or other agent of the United States, or its departments and wholly owned instrumentalities, or of any State or any department, agency, or political subdivision thereof, having possession of cigarettes in connection with the performance of their official duties.

"(c) the term 'common or contract carrier' means a carrier holding a certificate of convenience or necessity or equivalent operating authority from a regulatory agency of the United States or of any State or the District of Columbia;

"(d) the term 'State' means any State, or the District of Columbia, which requires a stamp, impression, or other indication to be placed on packages or other containers of cigarettes to evidence payment of cigarette taxes;

"(e) the term 'dealer' means any person who sells or distributes in any manner any quantity of cigarettes in excess of 20,000 in a single transaction;

"(f) the term 'Secretary' means the Secretary of the Treasury or his delegate;

"(g) the term 'person' means any individual, corporation, company, association, firm, partnership, society, or joint stock company.

"SECTION 1286. *Unlawful Acts.*

"(a) It shall be unlawful to ship, transport, receive, or possess contraband cigarettes.

"(b) It shall be unlawful to knowingly make any false statement or representation with respect to the information required by this chapter to be kept in the records of a dealer.

"SECTION 1287. *Recordkeeping and Reporting.* Each dealer shall maintain such records of shipment, receipt, sale, or other disposition, of cigarettes at such place, for such period, and in such form as the Secretary may by regulations prescribe. Dealers shall make such records available for inspection at all reasonable times, and shall submit to the Secre-

tary such reports and information with respect to such records and the contents thereof as he shall by regulations prescribe. The Secretary may enter during business hours the premises (including places of storage) of any dealer in cigarettes for the purpose of inspecting or examining:

"(a) any records or documents required to be kept by the dealer, and

"(b) any cigarettes kept or stored by the dealer at such premises.

"SECTION 1288. *Penalties.*

"(a) Whoever violates any provision of this chapter or regulations promulgated thereunder shall be sentenced to pay a fine of not more than \$10,000, or to be imprisoned for not more than two years, or both.

"(b) Any contraband cigarettes involved in any violation of the provisions of this chapter shall be subject to seizure and forfeiture, and all provisions of the Internal Revenue Code of 1954 relating to the seizure, forfeiture, and disposition of firearms, as defined in section 5845(a) of that Code, shall, so far as applicable, extend to seizures and forfeitures under the provisions of this chapter.

"SECTION 1289. *Effect on State Law.* Nothing in this chapter shall be construed to affect the concurrent jurisdiction of a State to enact and enforce State cigarette tax laws, to provide for the confiscation of cigarettes and other property seized in violation of such laws, and to provide penalties for the violation of such laws."SECTION 1290. *Enforcement and Regulations.* The Secretary shall enforce the provisions of this chapter and may prescribe such rules and regulations as he deems reasonably necessary to carry out the provisions of this chapter."

## SECTION 3.

(a) Except as provided in subsection (b), the provisions of chapter 60 of title 18, United States Code, shall take effect on the first day of the first month which begins more than 120 days after enactment.

(b) The following sections of chapter 60 title 18, United States Code, shall take effect on the date of enactment of this act: Sections 1285, 1286 (a), 1288, 1289, and 1290.

SECTION 4. The title analysis of title 18, United States Code, is amended by inserting immediately below the item relating to chapter 59 the following: "60. Cigarette Traffic ..... 1285."

## SECTION 5.

(a) Section 1(b) of the act of August 9, 1939, c. 618, 53 Stat. 1291, as amended (49 U.S.C. 781 (b)), is amended by:

(1) striking out "or" at the end of paragraph (2);

(2) striking out the period at the end of paragraph (3) and inserting in lieu thereof; "or"; and

(3) adding after paragraph (3) the following new paragraph (4) to read as follows:

"(4) Any cigarettes; with respect to which there has been committed any violation of any provision of chapter 60 of title 18 or any regulation issued pursuant thereto."

(b) Section 7 of the act of August 9, 1939, c. 618, 53 Stat. 1291, as amended (49 U.S.C. 787), is amended by:

(1) striking out "and" at the end of subsection (e);

(2) striking out the period at the end of subsection (f) and inserting in lieu thereof "; and";

and

(3) adding after subsection (f) the following new subsection (g) to read as follows:

"(g) The term 'cigarettes' means 'contraband cigarettes' as now or hereafter defined in section 1285(b) of title 18."



# PROPOSED AMENDMENT TO THE BUCK ACT

## An Act

To permit State and local governments to tax cigarettes [or other tobacco products] sold in Federal areas.

Amend title 4, chapter 4, section 110 United States Code by adding subsections (f), (g) and (h) to read:

(f) The term "cigarette" means any roll for smoking made wholly or in part of tobacco, irrespective of size of shape, and irrespective of the tobacco being flavored, adulterated or mixed with any other ingredient, the wrapper or cover of which is made of paper or any other substance or material except tobacco.

(g) The term "tobacco products" means cigarettes, cigars, little cigars, smoking tobacco, chewing tobacco and snuff made wholly or partially of tobacco or any substitute thereof whether flavored, adulterated or mixed with another ingredient.

(h) The term "a facility of an appropriated or nonappropriated fund activity of a voluntary, unincorporated association" means a facility authorized by law or promulgated by the head of a department or agency of the United States. Such facilities include, but are not limited to, post exchanges, ship stores, ship service stores, commissaries, officers and noncommissioned officers clubs, filling stations and licensed traders located on U.S. military or other reservations.

Amend title 4, United States Code, by adding section 113 to read:

SECTION 113. Tax on Cigarettes [tobacco products] sold on military or other reservations.

(a) Notwithstanding any other provisions of this act, all taxes levied by any State, territory, or the District of Columbia upon, with respect to, or measured by, sales, purchase, storage, or use of cigarettes [or tobacco products] may be levied in the same manner and to the same extent, with respect to such cigarettes [tobacco products] when sold by or through a facility of an appropriated or nonappropriated fund activity of a voluntary, unincorporated association, located on U.S. military or other reservations, within a State or territory imposing such a tax including the District of Columbia, when such cigarettes [tobacco products] are not for the exclusive use of the United States. Such taxes so imposed shall be paid computed on the basis of the rate imposed by the taxing jurisdiction, to the appropriate taxing authority of the State or territory including the District of Columbia within whose borders the selling facility is located.

(b) The officer in charge of such reservations shall, on or before the fifteenth day of each month, submit a written statement to the proper taxing authorities of the State, territory, or the District of Columbia within whose borders the reservation is located, showing the amount of such cigarettes [tobacco products] with respect to which taxes are payable under subsection (a) for the preceding month and remit such taxes to the proper taxing authority. No report or payment of taxes is required with respect to any cigarettes [tobacco products] purchased under circumstances where the tax is paid at or prior to time of purchase by the seller of such cigarettes [tobacco products].

## Appendix D

# Testimony Presented to the Advisory Commission on Intergovernmental Relations, December 16, 1976<sup>1</sup>

Statement by

**Leon Rothenberg**  
**Executive Director**

**Federation of Tax Administrators**

My name is Leon Rothenberg. I am Executive Director of the Federation of Tax Administrators, and in that capacity, I also serve as Executive Secretary of the National Association of Tax Administrators and the National Tobacco Tax Association. I express the thanks of the state officials who make up this panel for the opportunity to tell you of their concerns and recommendations with respect to cigarette bootlegging. These state officials have important responsibilities in the states' efforts against cigarette tax bootlegging, and it is my pleasure to introduce them, in the order in which they will speak. They are:

- Mr. Owen L. Clarke, Commissioner, Massachusetts Department of Corporations and Taxation. Mr. Clarke is President of the National Association of Tax Administrators.
- Mr. James H. Tully, Jr., Commissioner, New York State Department of Taxation and Finance.
- Mr. Arthur C. Roemer, Commissioner of Revenue, Minnesota Department of Rev-

enue. Mr. Roemer is Chairman of the Committee on Contraband Legislation of the National Tobacco Tax Association.

- Mr. J. Robert Murphy, Deputy Director, New Jersey Division of Taxation. Mr. Murphy is President of the National Tobacco Tax Association.
- Detective Edward Lorch of the New York City Police Department.

Among the several alternatives presented in the excellent ACIR staff report on cigarette bootlegging, the panel respectfully recommends that this Commission express support for the early enactment of federal contraband cigarette legislation. In making this recommendation, the panel points out that the National Association of Tax Administrators and the National Tobacco Tax Association, over a span of years, have adopted resolutions urging Congress to enact contraband cigarette legislation, and that these resolutions have had the unanimous support of the revenue departments of each of the 50 states.

## Cigarette Bootlegging—An Interstate Problem

The states feel that cigarette bootlegging is wholly an interstate problem which arises from the fact that under a federal system, each state determines its own tax rates and makes this

determination on the basis of a wide range of factors.

The fact that interstate tax problems in the cigarette tax field have become especially intense is attributable to the ease with which cigarettes can be transported across state lines, the price consciousness of cigarette consumers, the special appropriateness of cigarette taxes as a source of marginal state revenue, and most recently, the impact on cigarette tax rates of the U.S. Surgeon General's findings on the relationship of health and smoking.

With respect to the last, the disparity in state cigarette tax rates, which has always existed to a limited degree, was expanded sharply after the issuance of the Surgeon General's report in the mid-1960's. This occurred because some states viewed the findings as a valid and convincing basis for increasing cigarette taxes more sharply than ever before, while other states, notably the tobacco producing states, kept cigarette taxes at their former level.

#### **Limitations on the States' Capacity to Deal With Cigarette Bootlegging**

Without federal assistance, state revenue department efforts, even at an accelerated pace, cannot be effective against cigarette bootlegging (1) because of its interstate character, and (2) because the widespread presence of organized crime makes it a police problem of peculiar complexity rather than a tax administrative problem.

State tax enforcement personnel are auditors and investigators, rather than law enforcement officers, and their authority does not extend beyond the borders of their respective states. State revenue departments have given increased emphasis to law enforcement efforts because of bootlegging, but they are limited in these efforts by budgetary considerations and by the secondary position of cigarette taxes in state revenue systems.

The states' major taxes—sales taxes and income taxes—are administered at less than two percent of total collections. It would be difficult for a state revenue department to justify incurring costs in an amount equivalent to a double digit percentage of cigarette tax collections in order to cope with a police problem that is wholly interstate in origin.

#### **Urgent Need for Contraband Legislation**

There is an urgent need for the prompt enactment of a cigarette contraband bill. In 1972, the only time a congressional hearing was held on contraband legislation, federal agencies recommended a delay in federal intervention until the states had an opportunity to deal with the problem themselves.

The states have accelerated their efforts, but the failure of the federal government to apply its superior enforcement capacity has enabled cigarette bootlegging to grow and spread, while the presence of organized crime in these operations has become more firmly entrenched. State tax administrators believe that further delay in the enactment of a contraband bill would further entrench organized crime in this area, would magnify the bootlegging problem, and would make a solution to the problem more difficult than it is now.

#### **The ACIR Federal Uniform Rate Proposal**

There is general recognition that a complete solution to the cigarette bootlegging problem is possible only by making state cigarette tax rates more uniform than they are now. The ACIR staff report proposal for a federal incentive to induce greater uniformity has merit and is worthy of thorough examination.

However, the proposal may be much more controversial than the contraband bill because it involves the federal assumption of a state tax preserve, and it would necessitate that smokers in low cigarette tax states pay higher taxes in order to mitigate a problem which, superficially, appears to relate to the higher taxing states only. It is difficult to foresee early passage of the proposal, and the state revenue departments would hope that, if congressional consideration is given to the adoption of a uniform rate statute, such consideration would be preceded by the enactment of contraband legislation to deal with the severe law enforcement needs now confronting the States.

#### **Contraband Legislation and State Anti-Bootlegging Efforts**

The state revenue departments do not contemplate any diminution of their own anti-

bootlegging efforts if federal contraband legislation were enacted. Rather they anticipate that the presence of a federal enforcement agency in the campaign against bootlegging would contribute significantly to the states' effectiveness. The federal presence would provide a unifying influence which could include the training of state personnel and recommendations for statutory changes and operational improvements.

The ACIR staff report recommends that the states assume half of the federal enforcement costs that would result from contraband legislation. I believe that if this feature would increase the likelihood of Congress' enactment of contraband legislation, the states would accept this provision. They would be concerned, however, that questions might arise with respect to the implementation of the proposal which would further delay the enactment and effective application of federal contraband legislation. At the same time, it would be appropriate to point out that a strong case can be made for federal assumption of contraband enforcement costs. A substantial number of states are directly affected by cigarette bootlegging. The nation as a whole is affected because of the impact of cigarette bootlegging profits on organized crime nationally.

#### **Sales of Cigarettes on Military Installations**

My concluding comment is to express the state revenue departments' unanimous and full support for the ACIR staff report recommendation that Congress enact legislation allowing state and local governments to extend the cigarette tax and the sales tax on cigarettes to sales of cigarettes on military installations.

Statement by  
**Owen L. Clarke**  
President  
National Association of  
Tax Administrators

The report of ACIR, "Cigarette Bootlegging—A State and Federal Responsibility?" represents another of the high quality reports on state

problems with federal solutions which the staff of the Commission has submitted in recent years. Speaking both as President of the National Association of Tax Administrators and as Commissioner of Corporations and Taxation for the Commonwealth of Massachusetts, a state which has an extremely high exposure to bootlegging, I look upon this report as an incisive and informative analysis of this ever increasing cancer which threatens to subvert all attempts to improve state tax administration and which constitutes a real danger to the federal tax system as well.

The revenue loss which is attributable to bootlegging, now estimated to exceed \$400,000,000 a year, has become the source of the new "laundered" funds from which organized crime finances its take-over of what is too frequently referred to as legitimate businesses. Like it or not, this capital formation system, so huge in amount and so reliable in its availability, challenges all agencies of government—state, local and federal—to prevent the mushrooming expansion of organized crime into the field of tax collection. At a time when many states struggle with the spiraling cost of government, it seems incomprehensible that organized crime can divert such enormous amounts of state funds to criminal activities because they know that the states are unable to regulate interstate commerce and that the federal government refuses to recognize its responsibility to police interstate crime.

For the federal government to respond that bootlegging is a major problem in less than twenty states, and that therefore there is no impelling need for federal intervention, is to ignore the fact that over 60% of the population of the country resides in such states and even to more rashly dismiss the rapid inroads which bootlegging is making in all states.

Further, to retreat in the attack on organized crime by forcing a reduction in tax rates without first seeking to use the powers which are uniquely vested in the federal government seems to some to be abandonment or a surrendering of some of our national destiny to criminal overlords.

The failure of the federal government to now participate vigorously and effectively in the battle against cigarette bootlegging can only result in the consequences which the ACIR re-

port so adequately sets forth on page 4. The summary of findings on pages 5-7 are clearly supportable.

The recommendations which have been submitted have been reviewed by Massachusetts and from that one state's point of view I would respond to the major items as follows:

**Recommendation 2: Strengthen State Cigarette Laws.** Massachusetts does have penalties which could be increased in severity, although in the most recent case, following arrest and arraignment, the violator upon conviction, could be subject to a prison term of four years and a \$4,000 fine or both.

**Recommendation 4: Increase State Funding for Law Enforcement.** It is true that when tax rates are increased bootlegging inevitably increases. Experienced administrators, however, will support the fact that legislators too frequently relate the need for increased enforcement funds as more properly the province of police agencies rather than tax agencies. The enforcement needs are bypassed when the increased tax rates are enacted.

**Recommendation 5: Compensation for Affixing Indicia.** Discounts paid to affix indicia should be eliminated and Massachusetts supports the staff recommendation that such funds should be used to increase enforcement activities. We believe, however, that some analysis should be made of the different methods used for stamping. There is a strong opinion held by some administrators that bootlegging resorts to ink stamping devices in preference to paper stamps or decals. In Massachusetts I have recently ruled that no additional approval will be given for ink stamping and I have recommended that all indicia be by decals beginning in 1977.

**Recommendation 6a: Status Quo.** This recommendation, I believe, does not correctly state the full cause of or responsibility for bootlegging. It is true, of course, that high tax rates have impelled the problem. But the fact that the trafficking is across state lines severely inhibits state protective action and, therefore, the federal government, which alone can exercise interstate commerce restrictions, must bear much of the responsibility for controlling the crime. Federal assistance cannot and must not remain at the level now obtaining.

**Recommendation 6b: Increased Federal**

**Assistance.** Massachusetts expresses serious reservations about the effect which individual state enforcement procedures may have on bootlegging even with technical additions to staff if there is to be no participation of federal agencies in direct enforcement. Increased competency will have its positive results, of course, but its total overall effect on the enormous problem will be minimal.

**Recommendation 6c: Enact Federal Contraband Legislation.** Massachusetts endorses this proposal as the most effective and necessary recommendation in the report.

The total effort of the states which have been assertive in their enforcement activities is conclusive evidence that, absent federal contraband legislation, little can be accomplished by the states. The experience of the states and federal agencies with the provisions of the Jenkins Act when the agencies involved decided to participate with each other in the enforcement of it, demonstrates that a joint partnership of state and federal agencies is required and can, in fact, substantially reduce the incidence of interstate crime. Massachusetts will support the sharing of costs, but would recommend that all states be included in the contraband law.

**Recommendation 7: Federal Credit.** Massachusetts considers the credit proposals to be intriguing and inviting. Serious consideration should be given to them since they represent a long range solution to the bootlegging problem without serious adverse effect on future state revenues.

**Recommendation 8: Extend State and Local Cigarette Taxes to Military Bases.** The exemption from state taxes on sales of cigarettes on military bases can no longer be sustained on the basis that the exemption was proper when military pay was much lower.

Excess purchases on military bases constitutes an important area of evasion of taxes. Attempts to reasonably limit sales to actual per capita ratios on military bases have consistently failed. Even when extensive educational programs or specific public relations activity were directed to military personnel, the response to proper buying habits has not resulted in reducing excessive sales.

State and local governments should be in no different position than the federal government

in imposing and collecting cigarette taxes on military bases.

Massachusetts, with the reservations noted above, endorses the recommendations of the ACIR report and unless substantial changes are made, we expect to give strong support to the legislation which ACIR will be reporting to the Congress.

Statement by

**James H. Tully, Jr.**

**Commissioner**

**New York State Department of  
Taxation and Finance**

Mr. Chairman, members of the Advisory Commission and staff:

I first wish to commend the Commission for the intelligent, comprehensive report on cigarette bootlegging.

I have reservations about a few statements but these do not impact upon the recommendations.

As the report says, the most visible consequence of cigarette smuggling is the revenue loss to state and local governments in high taxed states which amount to about \$390 million each year (a figure we think too modest). This revenue loss is the main reason state tax administrators have become so concerned about the problem in recent years. The consequences of smuggling, however, extend beyond the loss of government revenues. Taxpayers pay higher taxes or receive fewer services, cigarette wholesalers and retailers are driven out of business and jobs are lost, political and law enforcement officials are corrupted, trucks are hijacked and warehouses raided, and people are injured and even killed. I can confirm that people are being killed and I'll tell you about that later.

Your sixth "finding" on page one, repeated on page five, states that cigarette smuggling is a law enforcement problem beyond the ability of most tax administrators. Let me suggest that almost all tax collection, other than amounts withheld, is a law enforcement problem. Further, state and local police agencies are not more successful in coping with bootlegging than

state and local tax administrators. I make this point only because I don't want anyone to be able to respond to all the valuable ideas in the report by saying: "Let the states turn this over to the state police." That will not be a solution. The entire report is a confirmation of this and explains why.

Also, on page five, your comments on state efforts do not acknowledge the major enforcement efforts made by many states in the past few years; often individually, occasionally in concert, sometimes with Federal assistance.

In the past eight months, we made 96 arrests; 25% were repeaters, 75% are connected with organized crime—our conviction rate is 85%.

But about the murder. Some weeks ago, we were pleased to have obtained arrests and later indictments of some organized crime elements who had become involved with legitimate businessmen in establishing a counterfeiting ring.

We recently learned that one of those who worked in with the counterfeiting scheme, Michael Connelly, 55 years of age, of Willingboro, New Jersey, was found in Philadelphia, with two bullet holes in his head. Mr. Connelly was the alleged fabricator of the device—which I hold up to you—the counterfeit stamp printer. Obviously, the rewards are so great that criminals will kill those whom they think might know too much.

Now to your recommendations. Your recommendation #3 on page 11 deals with public information activities by state governments. In the past year, we have publicized arrests of bootleggers and retailers. The public knows that a crime is being committed, that organized criminals are involved, and that vast sums of tax revenues are being lost. My task force on bootlegging held hearings, and they were publicized effectively.

Your recommendation 5, on page 13, deals with discounts to distributors (we call them "agents" in New York) who affix tax stamps. I know that New York's discounts are lower than all but a half dozen states, and our agents do have more extensive security arrangements. Because of the problem in New York, we are now trying to design a better stamp than we have now, less expensive to administer, more useful for law enforcement purposes.

**Recommendation 6—"The Federal Role."**

I suggest that you eliminate 6a—"status quo"—it doesn't work.

Recommendation 6b—"Increased Federal Financial and Technical Assistance," won't work either. The argument is made that state enforcement efforts are underfunded. This is not true in New York. We spend a million dollars a year, have received LEAA money in the past, have a full-time staff of over 65 people, vehicles and radio equipment, and we also have the help of the state police, the New York City Police Department and the City Finance Department. We use the sophisticated stamp device, a machine by Pitney Bowes. Yet, machines were made available to criminals and duplicated, operating for three months in three localities. That cost New York State \$135,000 a week.

On page 17, it is suggested that merely increasing Federal "assistance" would maintain a "proper balance" between state and Federal responsibility. "Proper balance" isn't a reason; it is a slogan. The real "proper balance" is that solution which might help solve a problem without wasting a lot of money.

I strongly support recommendation 6c to enact a Federal cigarette contraband law. State action goes a short distance here, and state cooperation not much further. We need Federal help. Jenkins Act prosecutions have been successful in some instances. Violation of the Jenkins Act should be a felony. One other argument against the contraband proposal, on pages 20 and 29, is that states must accept "responsibility" for enforcement. That implies sole responsibility without Federal help but that is not public policy in the United States. Federal assistance is provided to most state tax agencies in the enforcement of many state taxes. Incidentally, the states help IRS enforce Federal tax laws. There is, fortunately, more Federal-state assistance today than there is separation. And in our cigarette tax program, we have occasionally been helped by IRS, Postal Service, Treasury, Customs and the FBI. The argument about "sovereignty" on page 21 is not persuasive.

Page 21 suggests that smuggling is not a national problem. Only 23 states have serious or modest problems. I believe this is an understatement, just as I believe that the loss figure of \$390 million is low. During our recent coun-

terfeiting investigation, we obtained evidence that there is cigarette stamp counterfeiting in 40 states. Compare that with your statement on page 33 listing 8 states. More important, the 23 states with "serious" or "moderate" problems represent 70% of the population of the United States. It is these people who have the problem in lost public services, destruction of legitimate business, and increased organized crime.

The arguments against such a bill on page 61—that it might be unnecessary or unwarranted—are clearly false. I expect that the new officials in the Justice Department this January will take a more intelligent view. The Justice Department position, as of April 1974, as quoted on page 61 of your report, is despicable. But, of course, the Justice Department had its own problems in those days, and its position may have been defined under great stress.

Finally, I favor a uniform Federal tax, at a rate of 20¢ a pack with distribution to states based on cigarette consumption in those states. That would be easiest and most successful. There are less than a dozen manufacturers, and the tax could be collected by the government without difficulty.

But we must try a contraband bill first. A problem so vast which costs State and city governments millions of dollars must be addressed and a contraband bill is the very least that should be done.

Statement by  
**Arthur C. Roemer**  
**Commissioner of Revenue**  
**Minnesota State Department of**  
**Revenue**

Thank you for the invitation to testify before the Commission. I would like to preface my remarks by commending the ACIR staff for their excellent report.

Cigarette tax losses sustained by the states are a major concern of many of the states. A documentation of the estimated losses in revenue from cigarette bootlegging contained in the report indicates a net loss of 330 million dollars in tax revenues. It is not only the millions of dollars of losses of revenue with which the

states need be concerned but in many instances the traffic of cigarettes is corrupting local officials in the administrative branch of government and providing a focal point for commencement of other illegal activities such as liquor smuggling and burglary of cigarette warehouses and storage areas.

The matter is not of concern to all the states; only those states whose taxes are substantially higher than the low tax states and whose physical proximity is such as to make bootlegging profitable. Most of the states, in which bootlegging or "buttlegging," as it is often called in our state, is occurring to any substantial extent, have intensified their law enforcement activities. While I would admit that the states are not in all instances doing all they can to curtail or eliminate bootlegging, it must be recognized that the resources of the state are limited. This, coupled with the constitutional protections that are guaranteed to the criminal, result only in a small fraction of the traffic being apprehended and in many instances the real criminal is not apprehended, only the hired driver or distributor.

In several instances states have coordinated their enforcement activities through pooling of a portion of their resources. In our area, with Federal assistance in the nature of an LEAA grant, five states—Indiana, Ohio, Illinois, Michigan and Minnesota—formed the Interstate Revenue Research Center. Two additional states have now joined—Missouri and Florida. This cooperative arrangement has substantially increased surveillance capabilities, permitted the development of education programs, and resulted in additional arrests and seizures.

In our state alone (Minnesota), IRRC representatives met with over 600 law enforcement officials to increase their awareness and solicit their cooperation in apprehending cigarette tax violators.

As of July 1976, 33 subjects were apprehended and a total of 50,992 cartons of cigarettes seized having a value of over \$155,976. The annual potential tax savings resulted from breaking up these smuggling operations is estimated to be \$3,657,000.

This arrangement has, however, its limitations. The effectiveness of the agents of the IRRC has in many instances been severely curtailed since they become identified by the

criminal element, photographed and in some instances subject to countersurveillance.

While arrests and apprehensions in the member states have increased substantially as a result of the activities of the IRRC, they represent only the "tip of the iceberg." There are many other operators that are not being detected. More important than the actual arrests themselves has been the publicity that has resulted from the IRRC activities and the arrests, which tends to discourage possible violators from beginning or continuing bootlegging activities.

The United States Government, through the commerce clause of the United States Constitution, has been entrusted with the exclusive power to regulate interstate commerce. It is the delegation of authority that deprives a state of the power to control interstate commerce. On the other hand, having the sole and exclusive authority to regulate interstate commerce, it is only reasonable that the Federal government should impose such restrictions as may be necessary to protect the states from illegal transportation activities, and to assist the states in enforcing these restrictions.

It is obvious that the Federal government is losing millions of dollars in income tax obligations as a result of bootlegging activities. It is a well-known fact that little, if any, profit from criminal activities is reported for Federal income tax purposes.

It is our belief that syndicated organized crime of the East Coast variety is not operating in the Midwest. The usual type of organized crime is a loosely formed organization of truck driver, bartender and/or employees of large corporations who arrange for importation and distribution of cigarettes. In the case of the bartender, the method of distribution is under-the-counter sales to a number of known patrons, friends and associates; and in the case of plant employees, to fellow plant employees on order or otherwise. In some instances local petty criminals may be involved and distribute cigarettes to news stands, shoe shine parlors or filling stations, to be sold to selected customers, or the same channels as are used to dispose of goods acquired by burglaries or theft.

Another problem relating to bootlegging is that generally the fines imposed by state courts are not sufficient to discourage this type



of activity. The states need help. Legislation making illegal transportation of substantial quantities of cigarettes a Federal crime would be a great help. The psychological advantage would be tremendous as well as the assistance of Federal law enforcement agencies, particularly the Bureau of Alcohol, Tobacco and Firearms of the Department of Treasury. The Jenkins Act is a good example of the success of this type of legislation. Prior to the passage of the Jenkins Act, the United States mail was utilized as a vehicle for substantial bootlegging activities. While the Jenkins Act has not completely eliminated the use of the mail as a vehicle for the illegal transportation of cigarettes; that Act with the active support of the postal authorities, has substantially reduced bootlegging activities through the use of the mails.

I, therefore, strongly support Recommendations 6b and 6c of the report. We would be naive, however, if we believed that this type of Federal legislation would eliminate all bootlegging activities. Only the elimination of the huge profits resulting from the illegal transportation of cigarettes will end all bootlegging activities. We feel, however, that Federal legislation making bootlegging a Federal offense should be an important first step to be taken. If, after a reasonable period, that does not effectively solve the problem, then I would support additional steps such as that recommended in Recommendation 7a of the report. However, I believe the states should first be given Federal help, both financially and by making the transportation of substantial quantities of cigarettes a Federal crime.

We hope the ACIR will lend its support to the effort of the states to secure such legislation.

Statement by  
**J. Robert Murphy**  
President  
National Tobacco Tax Association

I am delighted and honored to have been invited to appear before the Commission and wish to express my sincere appreciation. In my visit, I am wearing "two hats"—one as the President of the National Tobacco Tax Association

and the other as Deputy Director of the New Jersey Division of Taxation.

Due to the time limitations, it is not my intention to be repetitious, as I believe that the Report of Wayne F. Anderson and his staff is an excellent, comprehensive study on cigarette smuggling, especially the statistics. I am sure you will agree that the North East is the "mecca" of the bootlegging entrepreneurs. However I would be remiss if I did not elaborate on certain problem areas outlined in the draft of your Report which I take exception to, in part.

The Report reflects six basic reasons why the states are experiencing difficulty in combatting the bootlegging problem. I support in toto four of the reasons; namely, 1, 2, 4, and 5. I offer the following comments in connection with 3 and 6:

**Number 3. Cigarette bootlegging is not a federal offense, and the interstate nature of the problem hampers State and local law enforcement efforts.** I agree there is no federal legislation that pinpoints cigarette smuggling per se; however, I do believe that indirectly cigarette smuggling does violate federal legislation:

a. ICC regulations are being violated. It is my understanding, and I am not an attorney, that Section 222 of the ICC Act indicates that any person hired to transport nonexempt items comes under the purview of ICC authority. I have been told that cigarettes are not exempt; additionally, that a first offender of such act is not fined. However, a second offender may be fined and/or subject to imprisonment.

b. Illegal practices (fraud by wire) are being employed by organized crime in the use of the interstate communications network (telephone, Western Union, etc.) to perpetrate their illegal activities.

c. Cigarette smuggling will definitely have an impact on income tax evasion and, as a result, the unreported income from the illegal activity would be a violation of Internal Revenue Service laws.

However, these violations are not timely with the overt act; i.e., seizure of the contraband cigarettes and arrest of violators. Further, it is the rare occasion that cigarette smuggling is the prime violation on any of these charges. Thus, the need for the legislation I strongly recommend for your consideration.

**Number 6. Cigarette smuggling is a law enforcement problem and most tax administrators are not equipped to handle such problems.** I concur in this statement from an overall viewpoint, but I must comment that the North East States have, because they are faced with the erosion of cigarette tax revenues:

- a. Either established specialized enforcement units within their commands and/or solicited the cooperation of their state or local police agencies to cope with illegal cigarette activities.
- b. Five of these states have specialized units, and the personnel assigned received police training. They are authorized to make arrests, carry sidearms and utilize sophisticated enforcement equipment.

The prime problem for the states in combatting cigarette smuggling is the lack of resources to conduct out-of-state investigations and appropriate federal legislation to support interstate smuggling prosecution.

The North East States have, for a few years, been operating informally in joint operations by sending enforcement agents to the low tax rate states to observe and investigate individuals purchasing cigarettes and transporting them to the North East States. I am sure you are aware that these North East States formalized their operation and are now known as the "Eastern Seaboard Interstate Cigarette Tax Enforcement Group" (ESICTEG). The states involved are: Massachusetts, Connecticut, New York, New Jersey, Pennsylvania, Delaware, Maryland and Northern Virginia. In addition, many state police organizations of these states are active participants in ESICTEG activities.

I note in passing that ESICTEG was trying and making progress in its action against bootleggers until the economic crisis emerged, but

this progress is not in pace with the increased cigarette smuggling. On three separate out-of-state surveillance operations, apprehensions resulting therefrom caused the cigarette smuggling operators to lose approximately \$250,000. Obviously, this is a prime example of what can be achieved when cooperation prevails between enforcement agencies both within and without the state. This was spasmodic and not a continuing plan of action. We believe that the violators were aware that we did not have the resources to operate full time. Problems were created as we did not have legislation to handle interstate cigarette traffic.

Of prime import to this group is its ultimate goal; i.e., to curb cigarette smuggling. As a team effort, it is immaterial what state makes the seizure and arrest, just as long as the results are successful. ESICTEG members have developed a close rapport with one another and are constantly communicating almost on a daily basis, disseminating intelligence information, fostering cooperation with all federal enforcement agencies, and developing cooperative interstate and intrastate surveillance operations.

Because of the fact that I am personally involved in ESICTEG activities, I can state unequivocally that cooperation permeates this organization. Also, they have the interest and dedication but cannot do it alone or as a group. They need the support in the form of funds and federal legislation.

Reference is made to the article in *The U. S. Tobacco Journal* of November 25, 1976, which illustrates an example of the cooperation that prevails between state and federal enforcement agencies. It indicates that Special Agents of the New Jersey Division of Taxation with the cooperation of the FBI, state and local police (includes NYCPD) smashed a multi-million dollar smuggling enterprise. Seized were 26,000 cartons of cigarettes, four conveyances, over \$10,000 in cash, and ten men were arrested, three of whom were principals of the operation and alleged to be affiliated with organized crime. Seven locations operated by the group were raided simultaneously by the enforcement personnel. Certainly, this could never have been accomplished without cooperation. However, this investigation took over a year to bring to a conclusion.

LEAA recognizes that cigarette smuggling is now a major source of revenue to organized crime. This is evident in the publication entitled "Combatting Cigarette Smuggling" dated January 31, 1976. However, up to the present time, LEAA has seen fit to make one grant of \$750,000 plus extensions, to attack this intolerable situation. ESICTEG has been trying to obtain a grant for the past year without any success. ESICTEG is ready—they have the manpower and dedication to do an outstanding job. However, they need funding to obtain a compatible in-car radio system, other enforcement equipment, and to defray traveling expenses, coupled with contraband legislation.

Unfortunately, the states are not in a position today to fully subsidize a continuing out-of-state enforcement program. Many states are precluded because of their constitutional provisions disallowing revenues to be dedicated for specific functions. An effective program necessitates surveillance action 52 weeks a year. Therefore, as a start, the need for LEAA funding is extremely essential.

Cigarette smuggling is not a "victimless crime." There have been numerous homicides connected therewith. In fact, the aforementioned apprehension in New Jersey resulted in a gangland figure being murdered. He was severely beaten, after which riddled with .22 caliber bullets and subsequently killed by a .38 shot through the mouth to the brain. In passing, I wish to state that Jack Anderson on television this morning [Dec. 16, 1976] commented on cigarette smuggling, the seriousness of it, and the crime connected thereto. He stated that federal officials were turning their backs to it. Detective Edward Lorch of the New York City Police Department will elaborate further about the violence connected with cigarette bootlegging and the achievements of the North East States to combat cigarette bootlegging.

Many of the states do not have the power of arrest or authority to carry sidearms for their enforcement agents and, therefore, cannot combat the problem without assistance.

The Report projects that the basic cause of cigarette bootlegging is the disparity of state tax rates. This is only partially true because several states have unfair cigarette sales acts. Such acts in many cases not only establish minimum sales prices between distributors

(stamp affixing agents), wholesalers (subjobbers—they do not purchase direct from manufacturers), and retailers, but also the minimum price that can be charged to the consumer. Additionally, many such laws also regulate cigarette manufacturers' promotional activities.

An example of this type of price disparity exists between New York State/New York City and New Jersey. New Jersey has a price law that is rigidly enforced; whereas, New York does not regulate prices. As such, in New York City, where the combined tax on cigarettes is about \$2.60 per carton and in New Jersey \$1.90 per carton, cigarettes can be purchased in New York City at about \$0.20–\$0.25 cheaper per carton. Therefore, even if a uniform tax was established nationally, price disparities would still prevail. Thus, contraband cigarettes would always be available on the "street."

The Report commented on the "Unfair Cigarette Tax Law." Time does not permit me to elaborate on the value of such a law so, with your permission, I would like to submit a position paper with my thoughts for your consideration.

The Report suggests that the states review discount rates, establish uniform tax rates, and enter into a tax rebate/credit plan with Federal Government. I contend this would be too cumbersome and risky to pursue, for it would create one mammoth administrative problem. Further, such a study would take too long and the states with smuggling problems cannot wait. It is just not practical and, personally, I feel the majority of the states would balk about accepting any such ideas because strong business groups (tobacco growers' associations, etc.) could create pressure in the political arenas. The state legislators would believe that the states would lose revenue or possibly not have the money available for cash flow.

In passing, I wish to state I solidly support the recommendation in the Report for the removal of exemptions of state taxes being imposed on cigarette sales at military installations.

You have heard or you will be hearing from other speakers that organized crime is infiltrating the cigarette smuggling area. As it becomes more involved, it will be difficult to curtail and eliminate. Organized crime has the manpower and resources to become involved

in all illegal activities. To commence a cigarette smuggling operation it takes little or no expenditure of funds. Intelligence information available is that organized crime handles 80 percent of the illegal cigarettes. We are all cognizant that there is a "fast buck" to be made in this multi-million dollar business. Organized crime has the sources to dispose of contraband cigarettes, and it will generally have the same clientele that are involved in their bookmaking, drugs, vice, hi-jacked and stolen merchandise, etc., operations. As organized crime meets with success, it will naturally expand its illegal activities. This expansion could be, if not already, in purchasing tobacco distributorships in low tax rate states which would furnish it an "open market" for cigarettes. The low tax state enforcement personnel worry about the infiltration of organized crime into legitimate businesses. However, industry will sell to anyone as they want to retain their profits and increase revenue. They give the indication that the states suffering with smuggling brought it upon themselves with high taxes. As indicated, heretofore, federal legislation could result in cigarette smuggling being additional violations to be considered by the Organized Crime Sections of the United States Attorneys Office against pending and future investigations of organized crime "figures." The states' enforcement agents would expand their cooperation with the federal officials. They would not dodge their responsibility in this endeavor because of the federal legislation. They would feel more secure in their investigations.

In conclusion, I wish to summarize that the states with cigarette smuggling problems cannot wait for studies to be conducted in certain areas, namely, tax rebates, uniform tax rates, etc., as the results would be long-range conclusions. These states need initiatives to curb cigarette smuggling now or the problem will increase. The revenue losses are increasing. These statistics are in Anderson's Report. Further, legitimate businesses are closing because they cannot cope with the competition of the illegal operation. Time is of the essence.

There is a need for LEAA funds to obtain the necessary enforcement equipment and sustain investigations in the "low tax rate" states. This is only a start. The funds cannot be obtained from the states due to the economy

crisis. Then simultaneously there is the need for federal legislation against "bootleggers" which I strongly recommend, coupled with state legislation to correct deficiencies, namely, to make tax evasion practices a felony, thus resulting in more severe penalties. Federal legislation could diminish cigarette bootlegging as the "casual" operator would fear the federal laws. Further, the impact would strike organized crime in that their operations would not be so open and, thus, not as frequent. They would have to utilize additional precautions against being seized with contraband cigarettes. Further, there should be increased cooperative efforts of enforcement agents among the states and with the federal agencies. The latter I submit exists but has been somewhat curtailed as a result of priorities of manpower and resources.

I commend you for your interest in our problems and your cooperation in assisting us in resolving them.

I am quite optimistic that the states with the aid of federal legislation and sufficient funding can do the job.

Thank you.

Statement by  
**Edward Lorch**  
Detective  
Intelligence Division  
New York City Police Department

Good morning Gentlemen. I wish to thank the distinguished members of the Advisory Commission on Intergovernmental Relations for providing this opportunity to speak on the serious problem of cigarette smuggling. It should be obvious by my presence at this hearing that the New York City Police Department considers cigarette smuggling to be much more than just a problem for tax collectors and bookkeepers. The New York City Police Department is involved in the enforcement of cigarette tax law because the disparity between taxes in New York and the tobacco producing states has created a source of new revenue for organized crime. Specifically, the Intelligence Division



of the New York City Police Department, to which I am assigned, has been directed to assist the efforts of the several states participating in the Eastern Seaboard Interstate Cigarette Tax and Enforcement Group in the prevention of cigarette smuggling and the apprehension of violators while continuing to cooperate with the New York City Finance Department and the New York State Tax Department in local enforcement efforts.

So that the commission members may better understand the scope of this problem, I will use as an example a case involving my office during the summer and fall of 1975. During July of 1975 information was developed by the Brooklyn Burglary Squad that a highly organized operation existed in New York City which was counterfeiting tax stamps on cigarette packages. This was the first indication that organized crime had realized that the greatest profit to be garnered from illegal cigarette sales lie in counterfeiting local stamps. This process allows the cigarettes to be sold at the full local price rather than the discount price at which cigarettes with North Carolina, Virginia or Kentucky stamps would be sold. The Intelligence Division was brought into the case to assist with the investigation because of our expertise in the field of cigarette tax problems. Extensive effort on the part of those participating in the investigation led to a warehouse in the Hunts Point Section of the Bronx. Surveillance at this location established a pattern of movement of both contraband cigarettes and persons in and out of the warehouse. It was established that the backers of this ring had organized crime connections, however they had insulated themselves from the day-to-day operations and never actually entered the premises. They therefore could not be directly implicated and could not be prosecuted. When sufficient evidence had been gathered and probable cause established, a raid was held on the subject premises during the early morning hours of November 1, 1975 which yielded 30,000 cartons of untaxed cigarettes, three cigarette stamping machines and the arrest of three persons. The number of cigarettes on hand was determined to be a one week supply and projected over the period of one year, this operation had the equivalent loss of \$40 million to the City of New York.

However, while this case gives an indication of the highly organized structure necessary for the importation and distribution of contraband cigarettes, it still does not present the total picture. The participating Eastern Seaboard Cigarette Tax and Enforcement Group states have, since February 1974, seized over one million cartons of untaxed cigarettes. Best estimates are that one contraband carton in ten is seized. Conservatively, therefore, ten million cartons of illegal cigarettes have reached the streets.

Tobacco producing states, while obviously not susceptible to a tax loss in this problem, have imported a new problem—organized crime. While the sale of cigarettes to smugglers is not in itself illegal within these states, it has become apparent that many of those persons making those sales are willing partners in smuggling operations, to the point of assisting in transport and in supplying armed protection for the smugglers. As a direct outgrowth of organized crime's desire for even greater profits from even cheaper cigarettes, both southerners and northerners alike have turned to hijacking of unstamped cigarettes while enroute from the manufacturers to local distributors. This increase in criminal activity in the tobacco producing states by local residents is further evidence of the increasing ties between southern and northern criminals. These hijackings result in increased tax loss in the north but they also hurt the tobacco manufactureres, private transporters, local distributors and eventually the economies of those tobacco producing states.

Perhaps the most overlooked aspect of the total problem is the associated violence. Cigarette smugglers have territories which they supply and while some of these territories are large and the smoking population great, there is an eventual saturation point reached; a time when new areas must be found in order that profits may continue to grow. If an attempt at expansion infringes on the territory of another dealer in contraband cigarettes, violence can, and often does, result. Known cigarette smugglers, Richard Grossman, Thomas Pelio, Joseph Pastore, Gennaro Ciprio, Thomas Marchese and others, have fallen victim to the "victimless crime" of cigarette smuggling as the subjects of homicide. The pictures that I have here

with me may not be pretty to look at but they make the point more strongly than my words ever could. While all of the men pictured had organized crime connections and were murdered as a result of their involvement in the illegal transport of cigarettes, there have been other instances of violence against innocent persons simply trying to make a living in the legitimate cigarette business. Many dealerships in the New York area are secured like fortresses and trucks making deliveries are more like armored cars than delivery vans.

Information recently developed by the New York City Police Department indicates that meetings of persons involved in cigarette smuggling have taken place in order to decrease conflict of territory, to increase efficiency in shipment and delivery and to more effectively infiltrate the legitimate cigarette industry. Experts in the workings of organized crime believe that family lines have been crossed and that all five New York families are cooperating in a unique fashion to increase revenue from contraband cigarette sales.

A check of arrest reports compiled by the New York City Police Department further reveals that a large percentage of those persons arrested for cigarette smuggling are also charged with bribery. Based on this fact it can be safely said that the corruption of public officials is an additional danger which this problem has lent itself to.

However, the saddest part of this problem is also its most unique. This is the one endeavor of organized crime that has the full cooperation of a large segment of the general public. Persons purchasing smuggled cigarettes are simply, so they believe, saving a few dollars on an overtaxed commodity. They, of course, do not realize that those purchases are in fact supporting criminals and criminal activities which they deplore.

I believe that a Federal law making the interstate shipment of contraband cigarettes illegal will make some substantial progress in combating this problem. While those involved in this criminal activity are relatively unafraid of local courts, they would be reluctant to become involved with the Federal courts. Such a law would wake up the general public to the seriousness of the problem and make them less likely to be consumers of contraband cigarettes.

Gentlemen, the smuggling of cigarettes can no longer be considered a local problem. It is one that effects many states, both those that produce and those that consume tobacco. It is threatening to destroy the wholesale tobacco industry. It is adding untold monies to the coffers of organized crime and it is increasing the belief among many that American cities are unsafe for the honest businessman and the average citizen.

My thanks once again to the commission for the opportunity to have offered these few comments. I hope they will be of some value to your deliberations.

Statement by  
**Louis H. Ehrlich, Jr.**  
Chairman  
Committee on Legislation and  
Taxation  
National Association of Tobacco  
Distributors

Mr. Chairman and Members ACIR:

Firstly, I wish to commend Mr. Kleine and his staff for the most excellent, comprehensive report before you. My name is Louis H. Ehrlich, Jr. I am Chairman, Rothenberg & Schloss, Inc., Kansas City, Missouri, and Chairman, Committee on Legislation and Taxation, National Association of Tobacco Distributors. This statement is presented on behalf of the National Association of Tobacco Distributors, whose membership provides a nationwide network for the distribution of tobacco, confectionery and kindred consumer products to over a million retail outlets—an extraordinarily heterogeneous assortment consisting mainly of independent entrepreneurs availing themselves of our American system of free enterprise. The extensive mix of products distributed includes, but not limited to, cigarettes, cigars, pipes, and smokers' accessories. My remarks will be directed primarily to Recommendation 6c.

With this background information, and at the behest of the Wholesale Tobacco Industry and its retail customers, we wish to urge expeditious

Congressional action to inhibit the growing cigarette bootlegging problem by enacting legislation prohibiting the transportation of contraband cigarettes in interstate commerce.

It is estimated that illicit bootlegging is costing the states and local taxing authorities approximately \$390 million in revenue annually. In addition, legitimate business (the tobacco wholesalers and retailers) likewise is sustaining losses in the million of dollars. Because of its magnitude and involvement of organized crime, the states cannot effectively cope with this problem lacking the resources, both revenue and enforcement personnel.

Cigarette bootlegging is not a localized problem for the individual states. It may have started as a problem for New York state, but it has now spread to other Northeastern states, the Southern and mid-Western states. It will continue to spread as states raise taxes to meet the need for added revenue and the tax differential continues between states. With 50 sovereign states each executing its rights based on fiscal needs in the levy and imposition of cigarette taxes, there is no likelihood for tax uniformity. Consequently, we now have a state-federal problem calling for Congressional action.

What has happened in New York on a major scale is occurring in other states in lesser varying degrees. Cigarette bootlegging costs New York taxpayers \$85 million annually in lost tax revenues from legitimate sales. It puts small, honest storekeepers out of business and costs people their jobs. It diverts cigarette business from normal trade channels and promotes ever-greater tax evasions. And it adds significantly to the financial plight of the City and the State of New York, which have called on the Federal government for financial assistance.

The recent report of the New York State Special Task Force on Cigarette Bootlegging and the Cigarette Tax includes the following statement. I quote:

Contraband cigarettes in the past have been retailed mainly through businesses which don't normally deal in tobacco products, such as beauty parlors, barber shops, and other such business places, as a convenience to

their customers and an added source of revenue for themselves—and even, as another example, from the back of a station wagon at a construction site. In recent months, however, the State has discovered that these untaxed cigarettes are being increasingly sold in legitimate retail outlets. In other words, more and more business men and women, who are law-abiding in other respects, have become law-violators by evading the cigarette tax. Moreover, they are assisting in robbing the State of much-needed revenue at the same time that they are becoming accomplices of big-time racketeers and small-time hoodlums. Perhaps most tragic, the legitimate retailers who have become tax-evaders by selling contraband are subjecting themselves to arrest and criminal prosecution with resultant disgrace to their families as well as themselves.

Manufacturers' trucks have been hi-jacked, resulting in heavy losses to them and an impact on their insurance rates. These hi-jacks are professional in nature and are believed to be the efforts of organized crime. Organized crime does not care whether the cigarette packs are stamped or without tax indicia, as they have the outlets to dispose of them.

Because of the increase in hi-jacking and wholesale thefts, to maximize the illicit profits in the high tax rate States, motor carriers are turning down legitimate cigarette shipments, and insurance rates of licensed cigarette warehouses are skyrocketing.

Investigations, surveillances, and informants have resulted in bringing to the attention of the States that the violators are becoming more sophisticated and move their operations frequently. Their sources of supply, routes of travel, places of reloading, storage warehouses, and sources of disposing of cigarettes are constantly changing, which makes for more difficult investigations and apprehensions.

In spite of accelerated state enforcement efforts, cigarette bootlegging continues to grow in volume and to spread geographically. The states do not have the manpower nor the revenue to control its growth nor provide adequate

law enforcement. For the past 2 or perhaps 3 sessions of the Kansas Legislature, bills were introduced to reduce the cigarette tax. It goes without saying the bills never got out of Committee. Nowhere have I read or heard any mention being made as to the shipment of alcoholic liquors made in violation of state laws to be a Federal offense. As to the wholesaler discount, in the interest of time I call your attention to the position of my Association on pages 115-116 of the report and to my letter of October 29th to Mr. Kleine which I would like to have included in the record of this hearing if consistent with your policy. We therefore conclude cigarette bootlegging, because of its complex nature, cannot be controlled nor eliminated at the state level and therefore this Federal contraband cigarette legislation must be enacted.

The association which I have the honor to represent at this hearing is abundantly equipped to supply supporting data for this presentation on request. I will now be happy to answer your questions on this subject, particularly relevant to the findings and recommendations in the report which accompanied the invitation to testify at this hearing.

Thank you very much.

Statement by  
**William A. O'Flaherty**  
President  
**Tobacco Tax Council, Inc.**

Let me begin by commending the staff of the Advisory Commission on Intergovernmental Relations for the thorough and complete study it has prepared on the cigarette bootlegging problem. The report reflects careful study and the gathering of data from many sources in preparation of the report. As president of the Tobacco Tax Council, an organization which is the spokesman for the Tobacco Industry on matters of tobacco taxation, I was pleased that the staff of the Advisory Commission sought out our opinions and viewpoints on this serious industry problem. As a matter of record, I appeared before the Commission study group on November 19, 1976 in Washington, D. C. and

presented a ten page commentary on the preliminary report of the staff. We appreciate the courtesy shown to us by your staff and thank you for the opportunity to appear here today to present testimony for your consideration.

In its study on the bootlegging problem eleven recommendations are presented. The Tobacco Industry can and will support several of these recommendations, but there are some recommendations that we cannot, in good conscience, support.

Of all the recommendations put forth by the committee, the two contained in Recommendation 7 (a and b) are the most adamantly opposed. Let me go on record as stating that the Tobacco Tax Council and the Tobacco Industry are unequivocally opposed to any suggestion of a federal uniform cigarette tax rate. We are opposed not only on grounds of its impracticability but have many other objections to such a proposal being considered. Foremost in our objections would be the injustice foisted upon states who have maintained good fiscal policies and kept the cigarette tax rate at reasonable and equitable levels of taxation. These states should not be penalized for the reckless economic policies of the high tax states who in their desperate search for needed tax dollars have over-taxed a commodity which has always supplied its fair share of the tax dollar.

In our opinion, Recommendation 3 of the report is by far the best recommendation and is in an area that the Tobacco Tax Council and the Industry at large is already working on. Recommendation 3 is to "establish educational programs to increase public awareness of the consequences of cigarette smuggling activities." We feel because the public and to a large extent elected officials and representatives are unaware of the consequences of cigarette bootlegging, a concerted effort should be made to inform all sectors of the population of the problems arising from cigarette smuggling. Obviously, of paramount concern to the states is the tax money lost to the bootleggers which would provide services to its citizens. The Tobacco Industry loses too. It loses in terms of a legitimate industry being strangled into economic death when organized crime takes over the wholesaling and retailing of cigarettes. And the average citizen of this country loses when

money made from smuggled cigarettes finances drug rings, prostitution, and loan sharking.

Recognizing this, the Tobacco Tax Council already has a movie and several educational programs in distribution depicting the problems of bootlegging. We will attempt to show this film to as many people as will watch. We will, along with the rest of the Industry, continue our programs to make the public more responsive to a serious problem through all the educational tools at our disposal.

Two other recommendations of this study also have our support. We agree in essence with Recommendations 1 and 2. Recommendation 1 deals with voluntary cooperation between state officials and Indian leaders where bootlegging is a problem on Indian reservations. Strengthening state cigarette tax laws by increasing penalties for interstate bootlegging is the objective of Recommendation 2. On Recommendation 4 which would set aside part of any cigarette tax increase monies to state funding of law enforcement programs seems like a reasonable approach. However, Recommendation 4 could be construed to mean that the cigarette tax rate would be increased to allocate money for cigarette tax enforcement. Though this is obviously counter-productive, we have seen stranger proposals enacted into law.

Recommendation 5 would set a fixed amount of compensation per cigarette stamp for tobacco distributors rather than a percentage discount. Obviously, some form of fair and just compensation must be given to distributors for playing the part of the collection agent for the state. Again this is in an area better left to each state to decide on its own merit.

Recommendation 8 deals with military exemption from state taxes and as such is related to casual bootlegging not to bootlegging by organized crime that threatens the safety of the Tobacco Industry.

Recommendation 6 is subdivided into three parts and deals with legislation on enforcement at the federal level on contraband interstate smuggling of cigarettes. This contraband portion of the recommendation is difficult to oppose because it is for a worthy cause but we do not believe it will solve the problem. The Tobacco Industry agrees with Recommendation 6a and 6b to maintain or increase federal technical and financial assistance.

As far as any other federal remedial legislation is concerned as is outlined in Recommendation 6c where federal cigarette contraband legislation would be introduced, the Tobacco Tax Council is opposed to further action by the federal government. Laws and even more laws will not serve to remedy a problem that is out-of-hand because certain states have by the imposition of high cigarette tax rates created a climate favorable to organized crime. If the profit motive for organized crime were removed by reducing the cigarette tax rates, the problem would solve itself. However, as long as the profit motive is there—and it is when you consider that the highest taxing states (Connecticut and Massachusetts) have a tax rate ten and one-half times as great as the lowest taxing state—no amount of laws at the federal level will solve the problem.

The Advisory Commission can be lauded in their attempts to focus on the enormity of the problem. The Committee realizes a problem exists and is trying to find a solution. The Committee has not fully recognized that the crux of the problem is the high taxing states.

In its study the Commission has distinguished between casual and organized bootlegging. Organized bootlegging did not exist until 1965 when New York doubled its cigarette tax and gave the underworld a ready and willing market for contraband cigarettes.

If federal contraband legislation should be passed, it will simply give to the states a false sense of security. When the prohibition amendment was put into effect it didn't solve anything either. Prohibition proved that enforcement alone could not do the job. With federal legislation the LEAA programs will dry up and the states will be left with virtually no enforcement agencies. In other words, enforcement alone is not the answer. It must go hand-in-hand with reduced state tax rates at the same time. For example, if the legislation, and the money, and the man power were available it would still be physically impossible to enforce laws against cigarette bootlegging enough to stem the tide. If an actual post were taken at one of the tunnels coming into New York City where toll booths make it necessary for traffic to slow or stop, can you imagine the traffic jam that would ensue if every truck, van and camper were stopped and searched.

Thus, even if there were laws, even if search and seizure without a warrant were legal, even if there were hundreds of law enforcement officials, and even if there were millions of dollars to use indiscriminantly, the public would not stand still for such an infringement on their time and their individual rights. The public did not stand still for prohibition and eventually the amendment was repealed. Why should the cigarette industry be bogged down in a federal tangle of laws that will have little effect on curbing organized crime?

New York State has realized the problem at last and its own Special Task Force on Cigarette Bootlegging and the Cigarette Tax held hearings which resulted in an official recommendation that New York City eliminate its eight cents per pack tax and the State reduce its tax rate by two more cents. State tax reduction is the way to solve the problem. Proper funding of LEAA programs will give financial assistance to local law officials who already know the problem. Tax reductions along with enforcement programs aided by a campaign to educate the public on the severity of the problem are the kinds of solutions needed—not federal legislation.

Federal legislation discriminates against the Tobacco Industry—an industry that provides thousands of jobs, an industry that is a vital sector of the nation's economy, and an industry that helps fill both state and federal coffers to the tune of more than six billion dollars annually. Why don't we apply this same kind of legislation to gasoline? or beer? or whiskey? or automobiles? or to any other commodity under the sales tax laws? Infeasible idea? So is punitive legislation for the cigarette industry.

The Tobacco Tax Council is making progress. Over the last few years through our efforts tax increases in the states have slowed. In 1976 only the District of Columbia has increased its tax rate thus far. In 1975 only four states increased their tax rates and three of these were in the New England states where the bootlegging problem is at its worst. A few years ago 20 tax increases would have been normal. Why not give the Tobacco Industry a chance to solve this problem by working for reduced tax rates and opposing further state increases instead of giving states a place where they can "hang their hat" and avoid reducing the tax rate?

In summary, the Tobacco Industry feels that two recommendations of this Committee depend on the circumstances in each individual state and that these proposals (Recommendations 4 and 5) are better left to each state to decide if such legislation is necessary or advisable. Recommendation 8, in our opinion, more appropriately deals with an overall situation concerning all excise taxes as they relate to the military establishment.

Five recommendations of the Study Committee have the support of the Tobacco Industry. Recommendation 1 which deals with voluntary cooperation between state officials and Indian leaders and Recommendation 2 which stresses strengthening state cigarette tax laws are both supported by the Tobacco Industry. Recommendation 3 which recognizes the need to educating the public to be aware of the cigarette smuggling problem receives the wholehearted endorsement of the Industry. We also support Recommendation 6a and 6b which would maintain or increase federal technical assistance and financial grants to the states to be used to supplement state law enforcement programs.

The other three recommendations—7a and 7b which would establish a uniform federal cigarette tax rate with rebates to the states and Recommendation 6c which would create federal contraband legislation—are unjustifiable and unworkable and as such are opposed by the Tobacco Industry. I respectfully submit that if any of these three recommendations are accepted that rather than facing the problem, this Committee would be "throwing out the baby with the bath water."

Thank you.

Statement by

**Morris Weintraub**

### **Council Against Cigarette Bootlegging**

In New York State's Legislature, when a proposal was made to double the cigarette tax from 5¢ to 10¢, the industry warned the State that there would be an approximate drop of 20 percent in cigarette purchases and a rise of cigarette bootlegging within the State of New

York. Unfortunately, we were talking to deaf ears and the tax was passed. Here we are—ten years later—and this is what has happened in New York State:

1. Over 480 million packs of cigarettes are bootlegged into New York State every year; or 1,250,000 packs per day.

2. 80 percent of the 480 million packs or 384,000,000 are bootlegged into the City.

3. 20 percent of cigarettes bootlegged are now being counterfeited.

4. One out of every two packs consumed by cigarette smokers in the City are bootlegged and one out of every four packs are bootlegged into the State.

5. The present situation which exists has been the same for the last ten years and now has gotten worse, evidenced by the recent seizures by the police of:

a. A warehouse in the Bronx, with 30,000 cartons of unstamped cigarettes, and stamping equipment. It is estimated that this organized criminal group was counterfeiting approximately 100,000 cartons per week for a profit to them of over \$200,000 per week or \$10 million tax free money annually.

b. The meters used to do the stamping were not found. Enforcement officials feel that the criminals are back in business and also wonder how many more there are like that.

c. Three stamping agents were caught counterfeiting state tax stamps on cigarettes.

6. The underworld has become the biggest distributor in the State of New York.

7. The facts are well known and documented that bootlegging cigarettes is a thriving ongoing business in the northeastern states. Paul Landau, former head of Pennsylvania's Bureau of Cigarette and Beverage Tax, and former president of the Eastern Seaboard Interstate Cigarette Tax Enforcement Group, said:

I'm convinced that smuggling cigarettes is the next most profitable enterprise for the mob . . . next to narcotics . . . and more lucrative than numbers or prostitution.

8. The police have documented the involvement of approximately four organized crime groups that are deeply involved in the illegal distribution of cigarettes, whether it be bootlegging, counterfeiting or hijacking.

9. Due to the bootlegging, counterfeiting and hijacking of cigarettes, the legitimate industry is disintegrating. The underworld is moving in and except for a very few people, nobody seems to care. For example, the aforementioned Eastern Seaboard Interstate Cigarette Tax Enforcement Group (ESICTEG), a dedicated group of enforcement officials throughout the northeast, has put in for a grant of \$350,000 to fight the interstate transportation of bootlegged cigarettes, and that request has been turned down by the Federal Government.

10. Due to budgetary problems, the City's cigarette enforcement unit has been cut, and the State's investigation Bureau responsible for cigarette tax collection has too few people to do the job.

11. In the last ten years, this is what has happened:

a. New York State and City have lost \$600 million in lost tax revenue.

b. The cigarette industry has lost \$2.5 billion in sales.

c. 50 percent of the employees of wholesalers and vendors have been thrown out of work.

d. 35 percent of the wholesalers have gone out of business.

e. The retail candy store and stands in office buildings are being put out of business.

f. Insurance costs have gone from \$200,000 to \$700,000 for the industry, and today many firms are unable to get insurance.

g. Hijacking is continuing unabated.

12. The criminals are having a field day in

this area. In New York alone in the last ten years:

a. They have netted around \$245,000,000 in tax free cash.

b. They have captured the sale of one out of every two packs in the City—and one out of every four packs in the State.

c. They have created a distribution system that covers every apartment house, every industrial plant, every office building and are now even making deliveries to homes.

d. They have bought wholesalers, so that they can now stamp their own cigarettes with state approval.

e. They have set up the most sophisticated counterfeiting operation and no one has been able to stop them.

f. They now supply their own retail outlets in high traffic areas to the destruction of all legitimate retailers and supermarkets who cannot compete.

g. They have moved heavily into vending areas, using their cash to push out legitimate vending operators who cannot compete.

h. They have made so much money, that they are financing every conceivable illegal operation in New York.

What you have heard is but a short summary of the devastating effect of the increase in cigarette taxes that has happened in New York. The same can be said about many other states such as:

• New Jersey - which has lost about \$119 million in taxes.

• Pennsylvania - which has lost about \$176 million in taxes.

• Connecticut - which has lost about \$86 million in taxes.

• Massachusetts - which has lost about \$32 million in taxes.

If you were to take the profit made by the bootleggers in the last ten years on the eastern seaboard alone, it would equal approximately \$750 million.

Moving out into the mid-West, we find losses this past year due to cigarette bootlegging as

computed by the Interstate Revenue Research Center as follows:

• Illinois - \$25 million; Michigan - \$14 million; Minnesota - \$17 million; Ohio - \$30 million.

We also find problems of bootlegging in Texas, Florida, Tennessee and a few other states. The reason I am bringing out all these figures is to endeavor to make everybody understand the magnitude of the problem and its seriousness.

In this ten year period this is what has been done to stem the increase of bootlegging in our nation:

1. New York City has created a special police task force.

2. New York State increased their number of investigators from 20 to 70.

3. Penalties and confiscation laws have been increased in most states.

4. Thousands of people have been caught and convicted—very few people have gone to jail.

5. New York State has had internal investigations:

(a) The State Investigation Commission Report in 1972.

(b) The State Task Force Report (called the "Donati Report") in 1975.

6. The Eastern Seaboard Interstate Cigarette Tax Enforcement Group (ESICTEG) with limited resources has been in operation.

7. Most states today who are having a bootlegging problem have started to realize their situation and increased their enforcement groups.

8. Congressman Peter W. Rodino held hearings on cigarette racketeering and documented the problem.

9. The Interstate Revenue Research Center funded by LEAA funds has been functioning a year in the mid-West.

10. Last, but not least, we are being studied by the Advisory Commission on Intergovernmental Relations which is attempting to make recommendations to overcome this serious problem in our country.



No matter which way we turn and no matter what we are going to do, we must come back to the only solution, and that is to do away with the wide disparity of tax between the low tax states, such as North Carolina (2¢), Virginia (2½¢), and the high tax cities and states such as New York City (23¢), Connecticut (21¢), Massachusetts (21¢), etc.

The high tax states through their unreasonable and inordinately high cigarette taxes have created this problem. It becomes their responsibility to rectify this destructive and untenable situation.

I would like to reiterate from my statement before the Committee of the Judiciary, House of Representatives at the Hearings on the Elimination of Cigarette Racketeering:

As an industry representative I support any effort . . . aimed at curtailing cigarette bootlegging and preventing the destruction of the legitimate industry by organized crime. However, I would be remiss if I did not express to the members of this committee what I expressed to the New York State Investigation Commission at its hearing in 1972. . . . It is my conviction that cigarette bootlegging has become so rampant in this country as to defy enforcement efforts alone.

I have said many times in the past and I will say it one more time for the record: Enforcement alone, unless coupled with a reasonable rate of cigarette taxation, has never been and will never be an effective solution to the bootlegging problem.

Even though this statement was made on September 28, 1972, it is as important today as it was then and expressed my feelings completely.

Gentlemen, I deeply appreciate your Committee so competently and thoroughly looking into this very serious problem and I would like to bring to your attention the fine work of your staff in their knowledgeable and excellent preparation of the preliminary document they have presented to you.

I also want to personally thank you for

giving me the opportunity to appear before you today.

Thank you.

Letter from  
**Rufus L. Edmisten**  
**Attorney General**  
**State of North Carolina**

7 December 1976

Mr. Robert Kleine  
Senior Resident in Public Finance  
Advisory Commission on  
Intergovernmental Relations  
Washington, D. C. 20575

Dear Mr. Kleine:

I have recently been sent a copy of your memorandum dated November 24th, 1976, entitled "Cigarette Bootlegging: A State and Federal Responsibility?" as well as a copy of the full report done by your Commission. You and your staff did a commendable job in putting together this study and in presenting an objective overview of the cigarette bootlegging situation.

I, as Attorney General of North Carolina, am by statute the Chief Lawyer and Law Enforcement Officer for the State. In this capacity and as an elected official, I have been afforded the opportunity to examine the cigarette smuggling situation from all angles. It is my firm belief that the majority of the citizens of this State, myself included, feel that the "high tax states" have brought this problem upon themselves. They should not expect North Carolinians to suffer financially so that they may continue to impose exorbitant cigarette taxes through which to finance their governmental operations. I realize that many states, particularly New York, are in a very critical financial condition and that a reduction in the cigarette tax would worsen their financial situation. However, these states imposed this tax knowing full well the potential consequences.

The economy of North Carolina is very much affected by our tobacco industry. To take any action which would damage one of our

State's largest industries would be financial suicide. Our State does not impose any unusual or restrictive taxes on the products of any of the other states, thus creating a bootlegging or smuggling problem for North Carolina. We only ask that the other states treat us as well.

I have been contacted by numerous laws enforcement officials from the northeast for assistance in curtailing the bootlegging of cigarettes out of North Carolina. I have told them, as I will tell you, that I have asked the State Bureau of Investigation to try to be of service when possible. However, we have priorities in North Carolina for the use of our law enforcement personnel just as other states do and I just cannot justify their spending countless hours looking for cigarette bootleggers who are not in violation of any of North Carolina's statutes when we have numerous major crimes yet unsolved.

I was particularly concerned with your advocacy of increased federal intervention through legislation such as your "Federal Cigarette Tax Credit Proposal." Our trouble today is that people are already governed to death. If a proposal such as your 7a were to become law, it would be yet another example of unwarranted federal intervention with the free enterprise system.

I would appreciate very much your keeping me advised of the workings of your Commission in the so-called cigarette bootlegging area. If I can be of any assistance to you on this or any other matter, please do not hesitate to call upon me.

Sincerely,

/s/ RUFUS L. EDMISTEN  
Attorney General of  
North Carolina

FOOTNOTE

These statements were made prior to the finalization of the report and recommendations. The series of recommendations have changed. The following is the list of recommendations to which the statements refer. Various recommendations were subsequently dropped or changed:

- Recommendation 1: Encourage Cooperation Between State Tax Officials and Indian Leaders to Facilitate Collections of State Cigarette Taxes
- Recommendation 2: Strengthen State Cigarette Tax Laws
- Recommendation 3: Establish Education Programs to Increase Public Awareness of Consequences of Cigarette Smuggling Activities

- Recommendation 4: Increase State Funding of Law Enforcement Programs
- Recommendation 5: Compensation to Cigarette Distributors for Affixing Tax Indicia
- Recommendation 6a: Maintain Federal Technical and Financial Assistance at Current Levels
- Recommendation 6b: Increase Federal Technical and Financial Assistance
- Recommendation 6c: Enact Federal Contraband Cigarette Legislation
- Recommendation 7a: Federal Cigarette Tax Credit Proposal
- Recommendation 7b: Prospective Federal Tax Credit Plan
- Recommendation 8: Extend State and Local Cigarette Taxes to Military Bases

AN EXPLANATION OF THE ACIR METHODOLOGY  
FOR ESTIMATING REVENUE GAINS AND LOSSES  
RESULTING FROM CIGARETTE TAX EVASION

The ACIR method for estimating 1975 revenue losses (or gains) associated with cigarette tax evasion is a three-step procedure.

The first step involves the estimation of the impact of cigarette taxes (cents per pack) upon per capita cigarette sales. The second step separates this impact into two distinct parts, that related to cigarette tax evasion and that related to the effect cigarette tax rates are thought to have in discouraging consumption. The third step uses the results of the first two steps in order to obtain individual state estimates of the per capita sales gains and losses, which are then converted into revenue gains and losses for each state. A more detailed description of the methodology is contained in the report, however, several comments should be made here concerning the findings and the interpretation of these findings.

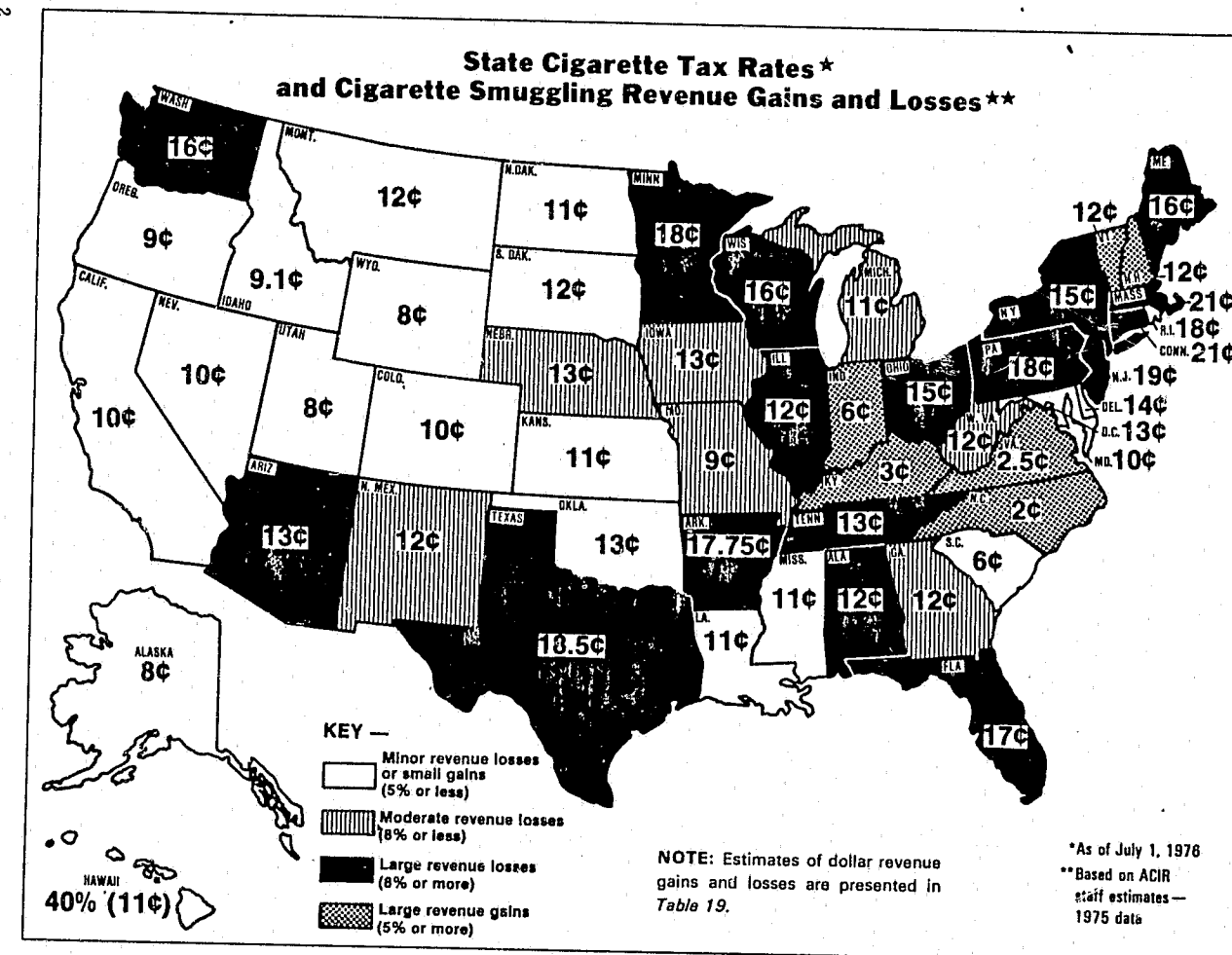
In the first step of the estimation process, a statistical approach known as multiple regression analysis was employed to isolate the effect of the cigarette tax rate from other factors thought to determine per capita cigarette sales, such as per capita income, age distribution of the population, and tourism. Based on a study of fifty states in fiscal 1975, the overall impact of tax

rates on per capita cigarette sales was found to be quite large and statistically significant. This finding, while consistent with other recent studies of cigarette demand, contrasts sharply with the views of many legislators who may not anticipate substantial reductions in cigarette sales to follow cigarette tax rate increases.

We concluded, on the basis of our study and others, that reduced consumption accounted for only 40 percent of the overall affect of tax rates on per capita cigarette sales. The remaining 60 percent was assumed to be attributable to cigarette tax evasion. While this assumption might give rise to an element of uncertainty, we are convinced that it represents a realistic and thoroughly defensible position.

Caution is suggested in referring to the state-by-state estimates of revenue loss (or gain) due to cigarette tax evasion because in making each individual state estimate the nationwide 40-60 percent assumption was applied.





Senator KENNEDY. We will call Mr. James Tully, Commissioner of New York State Department of Taxation and Finance.

**STATEMENT OF JAMES H. TULLY, JR., COMMISSIONER, NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; ACCOMPANIED BY ALFRED DONATI, JR., DIRECTOR, SPECIAL INVESTIGATIONS BUREAU; AND PAT VECCHIO, ASSISTANT DIRECTOR, SPECIAL INVESTIGATIONS BUREAU**

Mr. TULLY. Good morning, Senator. First of all I want to thank you for this opportunity to present our case. I want to introduce Al Donati, who is head of the Special Investigations Bureau of the Tax Department. He is a former Assistant U.S. Attorney for the Southern District of New York and he was head of the Organized Crime Task Force of the State Investigations Commission under the previous administration.

Here also is Pat Vecchio, who is the Assistant Director of the Special Investigations Division of the Tax Department, and is a former lieutenant in the New York City Police Department.

I heartily endorse the provisions of S. 1487, offered by Senators Bellmon and Anderson, a bill to eliminate racketeering in the sale and distribution of cigarettes. The bill is supported by Governor Carey, the National Association of Tax Administrators, the National Governor's Association, the National Tobacco Tax Association, and is consistent with recommendations adopted by the U.S. Advisory Commission in Intergovernmental Relations almost 1 year ago.

For decades, the Congress has considered, and then enacted, various forms of Federal aid to States. Federal tax revenues are distributed to States and localities. This bill is better than revenue sharing. It will allow States to get more revenue from their own tax systems, at almost no cost to the Federal Treasury.

This bill will provide Federal assistance to help enforce the States' tax laws. This would not be unique. At present, many Federal programs or statutes help States enforce their own tax laws, as there are scores of Federal programs to help States administer and enforce other laws. This bill is also good because it would help solve the problem without requiring low-tax States to increase their taxes. Officials of such States, and rightly so, resist efforts to raise taxes on their own people unnecessarily merely to help high-tax States enforce their tax laws. Thus, Federal help with the bootlegging problem will also serve to end some of the interstate hostility arising from the present situation.

Senator KENNEDY. What is the nature of this interstate hostility? What is its extent and frequency?

Mr. TULLY. It is unfortunately frequent and quite extensive. As a matter of fact, within 48 hours we had a surveillance within 60 miles of where I am now; and a person got in touch with a cigarette warehouse to attempt the buy, and was told to be careful because the place was under surveillance by what the business people thought were either Federal or State of New York officials. When they were asked how they knew that, they said they were informed by the local police.

Our investigators have been ordered out of places in North Carolina.

Senator KENNEDY. Why is that? What is the reason for the lack of cooperation?

Mr. TULLY. I would suspect that in a small town in the South—and I'm talking about local police and not State officials of any State—but in the political context of a small town, of course, a local policeman is much more interested in pleasing the local citizenry than he is in pleasing the State of New York.

I might say, Mr. Chairman, that I wondered if just the fact that you have held hearings has gotten the Federal Government involved. A person said that they wondered if Federal agents were down there to enforce the law, when, of course, there are no Federal agents as far as we know in these places.

But in any event I think that is one reason for that hostility.

A second reason, of course, and this is addressed to one of your previous questions about interstate cooperation, local law enforcement officials are burdened with crime enforcement. It is hard for them to become terribly interested in a problem that concerns the State of New York. They have their own problems and it's hard for them to get involved in our problems.

There are many forms of cigarette tax evasion, from the fellow who drives 10 miles into the next State to buy three cartons for his personal use, to the organized, well-financed operation that moves cigarettes in vans carrying 60,000 cartons. We use the word "smuggling" to describe those who engage in the business for a profit. And such smuggling is illegal. It includes:

(a) Railroad employees going down to North Carolina and bringing back quantities of cigarettes on return trips.

(b) Airline employees going to the Virgin Islands on free transit and bringing back "in-bond" cigarettes.

(c) Armed Forces personnel abusing their post exchange privileges and bringing in quantities of untaxed cigarettes.

(d) Individuals purchasing cigarettes for themselves and for their neighbors when they are in a low-tax State.

(e) Individuals purchasing cigarettes on Indian reservations.

I might add, Senator, in answer to a previous question that you asked about why was it so difficult to follow these vans from North Carolina to New York. You must not underestimate the sophistication of these people. There are the changed vehicles and the changed license plates. I think the most sophisticated method I have heard was that in one case a van moved off the road. This huge van opened and two smaller vans came down a ramp and got away that way. Our people were looking for the big van.

We don't need a Federal statute for these situations. For example, a concerted New York State-New York City effort in 1966 did quite well against the small smugglers.

Senator KENNEDY. How do you distinguish between the small ones and the large ones?

Mr. TULLY. It is not so much percentagewise as amount. I think the 100 cartons is a large one. Anything smaller than that is to us a small one. One of your previous witnesses talked about 50 cartons being the dividing line. But our problems are such that I consider 100.

Senator KENNEDY. What percentage of this activity is controlled by organized crime?

Mr. TULLY. I go into that in my statement later on but I think in New York State—and I will let Mr. Donati answer that—but I think it is more than half.

Mr. DONATI. Yes; as you can understand, Senator, it is difficult to put a percentage on its activities. It is very, very substantial. It is definitely more than half and perhaps 75 percent of the activity in this area in New York City.

Mr. TULLY. The "key" provision in this bill is the definition of "contraband cigarettes"—20,000 cigarettes or 100 cartons found in a State without the tax stamp appropriate for that State. Obviously, there are a few exceptions, carefully spelled out, where a legitimate dealer or carrier would have such unstamped cigarettes in his possession—before the stamps were put on. As presently administered, licensed wholesalers in the various States get untaxed cigarettes and then, acting as agents of the States, affix the appropriate tax stamps.

But, while the thrust of Federal participation is against the transportation of cigarettes to avoid State taxes, we also hope that the bill's recordkeeping provisions, and Federal intelligence-gathering activities, will also be of help in a problem related to bootlegging—that of counterfeiting State tax stamps.

I want to point out that Federal participation essentially stopped the flow of untaxed mail-order cigarettes into New York State. I think that is a very important example, Mr. Chairman, that the Jenkins Act was a great success. In 1970, 35,000 cartons a day were being mailed into New York. Two years later, it was cut below 300. The problem was 99 percent solved. The basic legislation against illegal mail-order cigarettes, the Jenkins Act, was enacted in 1949 after 4 years of real effort by the States after World War II. Then, in the early seventies, postal authorities made a concerted drive, supported by U.S. attorneys in Southern and Northern States, and the mail-order business was brought under control. I have no objection to the business as such—if people want to order their cigarettes that way. I do object when the mail order becomes a means of tax evasion.

We know that States are losing hundreds of millions in tax revenues because of all these violations and that most of the loss is caused by organized bootlegging. The recent ACIR study cites a survey done for the Law Enforcement Assistance Administration by the Battelle Law and Justice Study Center in 1975. It suggests that organized cigarette smuggling is the major problem in 10 States. It is at least a minor problem in other States.

If one looks at the 1976 ACIR study, on page 30, we find serious smuggling problems in 14 States and moderate problems in 9. I admit that not all of the problems in these 23 States are caused by organized crime. But there is a risk that organized crime will move in to take over much of the smuggling, just as it has moved into the activity in New York and other States. During our investigation into counterfeiting in New York, we used eavesdropping techniques and heard one mobster discussing opening an operation in Arizona.

[Chart shown.]

Senator KENNEDY. This chart indicates that.

Mr. TULLY. Yes; the first chart is the major revenue loss States; and now added are the States in which it becomes a moderate revenue loss.

But the large revenue loss, as you see, Senator, and as you pointed out earlier, those States stretch across the country.

The percentage of loss in New York is fourth in the Nation. I believe it is 17.4 percent of estimated revenues lost.

Texas is only one-tenth of 1 percent behind us, 17.3 percent.

The State of Washington loses more than the State of New York, it is 18.8 percent.

And it was a national problem 5 years ago when this issue last received serious consideration in Washington. The 1972 Report of the New York State Investigations Commission quoted William O'Flaherty, president of the Tobacco Tax Council, saying, "Bootlegging of cigarettes is rapidly becoming a nationwide problem." That same year saw a solid report on the problem by State Representative Thurlington, of Florida.

Let me discuss counterfeiting for a moment. Counterfeiters usually pay commercial bribes to purchase unstamped cigarettes. They pay the local State's taxes, and then a premium to the wholesale agent for not affixing the local stamps. They are then transported, stamped with counterfeit stamps, and distributed through legitimate channels.

In New York, counterfeiting fell off during the late 1960's and early 1970's because other evasion methods were easier or more profitable. But as law enforcement pressure increased on other tactics, we have had a resurgence of counterfeiting. The Battelle-LEAA study of 1975 indicated that at least 8 States have some evidence that stamps are being forged or counterfeited. Among them are Florida, Louisiana, Texas, and Wisconsin—so much for the argument that this is only a regional problem. Minnesota had a counterfeiting case as early as 1965.

In New York last year we smashed a cigarette counterfeiting ring led by Morris Kessler. We have evidence that Mr. Kessler was associated with the crime family, but I must say the matter is still in the courts. This group was working with several licensed cigarette wholesalers and dealers. We seized three tax stamp counterfeiting machines, several tax stamp metering machines which had been duplicated for use in the operations, and 50,000 cartons with counterfeit tax stamps. Later in the year Illinois revenue agents broke up a tax stamp counterfeiting ring and seized 24,000 cartons. In November 1975, the New York City Police Department seized 30,000 cartons of counterfeited cigarettes.

Organized crime will commit murder to protect its investment. One figure, Michael Connelly, was found dead with two .38 caliber slugs in his head. He had been involved in cigarette tax stamp counterfeiting for years. He reportedly received \$5,000 for designing a motorized cigarette stamp device. We believe he was killed after we broke up the ring because he might be connected with it, and might talk.

[Machine shown.]

In Rochester, N.Y., last year, a cigarette stamping machine was stolen from a legitimate agent. It turned up later in Brooklyn.

Let me provide some basic information on the role of organized criminal elements. The Law Enforcement Assistance Administration will confirm, I think, that organized crime is heavily involved in cigarette bootlegging and reaps major financial rewards.

Organized crime comes in because it is thought to be a victimless crime. The head man doesn't have to get close to the action. If captured, sentences are low and there is a fast turnover of cash. You were asking about the penalties that the truck drivers get. Of course, the fellow who is really running the show doesn't have to worry about the penalty.

The first organized crime influence was in the mid-1960's by Anthony Granata and his original backers, Ralph and Mario Gigante, both Genovese family soldiers. Such involvement has increased steadily.

Records of New York City and Philadelphia police showed five murders in connection with illegal cigarette sales in 1975.

Ralph Salerno, formerly an organized crime expert with the New York City Police Department, reviewed in 1977 the arrest records of 60 people charged with cigarette bootlegging. There had been 38 previous arrests for narcotics, 41 for burglary, 34 for grand larceny, 203 for gambling, 33 for weapons possession, 7 for kidnapping, 5 for attempted murder, 5 for extortion, 33 for assault, 11 for robbery, 26 for receiving stolen property, 11 for bribery, and 6 for rape. In other words, these are not your unemployed factory worker trying to hold his family together, nor some hard working fellow trying to earn a little extra money.

This is big business, and it tries to protect itself. Organized crime already had some control over part of the vending machine business. Now they can put untaxed or counterfeited cigarettes in the machine and increase the profit margin.

While smuggling in the mid-1960's did cut into the legitimate market, the penetration by organized crime in the late 1960's destroyed legitimate businesses—truckers, wholesalers. Even the local candy stores depend on cigarette sales for a part of their total business volume. When they lose sales to outlets for bootleggers, that loss may be enough to make the store a losing proposition.

As their commitments to their distribution network grow, they pursue "vertical integration." They will try to guarantee sources of supply by taking over, one way or another, cigarette wholesalers in the distributing States, then the producing States, or maybe manufacturers. Mr. Joe Edens, Chairman of the Board of Brown & Williamson Tobacco Corp. and Chairman of the Executive Committee of the Tobacco Institute, testified 4 months ago about this part of the problem.

He said:

The legitimate cigarette industry in New York City is being forced out of business by cigarette bootlegging. Already more than a thousand small businesses have been forced to close their doors permanently because they could not afford to compete with the prices on bootleg cigarettes. It is reasonable to suppose that this menace will spread statewide and through the entire industry.

So much for the distribution. But his remarks as a manufacturer are equally ominous:

We do not relish the prospect of awakening one day to discover that we must deal with organized crime, that we must pay the kickbacks, submit to the extortion, live with the threat of violence. It is disturbing to find out that criminal elements are moving into your business.

While there are many people in the bootlegging business who are well known, there are others who operate on the fringes. They are certainly "organized" and certainly "criminals," but they don't fit

into the media-concept of structured "crime-family" relationships. On the other hand, those arrested for cigarette bootlegging or counterfeiting have included 8 members of the Columbo organization and 11 of the Vito Genovese organization, as well as members from the Gambino, Decavalcante, Bruno, and Luchese groups.

How does it work? Bootleggers can get supplies at 300 to 500 places in North Carolina, Virginia, and Kentucky.

Illegal cigarettes have been transported in planes, buses, large trucks, trucks disguised as lumber or pipe carriers, a horse-carrier, mobile homes.

The drivers from North Carolina are paid an average of \$150 per trip. The organizer places his order via telephone with a North Carolina supplier. The money may be delivered in cash by a North Carolina contact. The cigarettes are usually wrapped in brown paper or in boxes. These cases are then marked according to the customers' instructions. The purpose of the markings is to permit a quick distribution to their customers without checking the contents of the package. These packages are then taken to an out-of-the-way location for a prearranged pick-up.

The truck driver does not usually know the head man. He has been given a routing and a phone number to call when he arrives in New Jersey. He is then given instructions where to deliver the load. It is often delivered to a warehouse in north Jersey.

Distribution is sophisticated. A joint investigation by New Jersey and New York City authorities traced one large tractor trailer. It made stops in Trenton, Newark, New York City, and Connecticut. At each distribution point, cars and small vans pick up the supplies for dispersal to outlets.

Smaller operators go to North Carolina by car or small truck and pick up directly from the supply source. They resort to various evasive tactics such as using rented vehicles, switching license plates or having a woman or a child with them.

But supplies are guaranteed in other ways if necessary.

The gangs will hijack trucking companies or independent smugglers. There were 25 hijackings in New York City alone in 1971. Hijacking of unstamped cigarettes from legitimate transporters occurs quite often. These cigarettes are disposed in the same channels as the illegally stamped cigarettes. A hijacking anywhere in the East might end up in New York.

There are instances of cigarettes being shipped into New York with false bills of lading. We have intercepted shipments made by air cargo through Kennedy Airport. One shipment was marked "rubber goods," another "plastics." A truck shipment from Virginia of a large case marked "machinery" and supported by bills of lading indicating the shipment was going to Lima, Peru, turned out to be illegal cigarettes. Warehouses are burglarized.

Let me provide some recent examples:

Mr. "C" was reported missing on February 2, 1974. He was found dead in the trunk of an auto parked on a residential street in Queens. "C" was originally financed in the cigarette business by a member of the Genovese organized crime family. It is believed that he had lost several cigarette shipments to hijackers and to law enforcement. It is further believed that he was so deeply in debt to loan sharks that, in

order to regain solid financial ground, he and his partner turned to the hijacking of both legitimate and illegitimate cigarette shipments. He was probably killed for a combination of these circumstances.

Mr. "C's" partner was also reported to be missing on February 2, 1974, and is believed to be dead. He was probably killed because of his involvement with Mr. "C."

Mr. "D" was walking in the street on the evening of August 1, 1974, in the Sheepshead Bay section of Brooklyn, when shots were fired from a passing auto, striking and seriously wounding him. "D" is believed to be an important factor in cigarette smuggling for the Joseph Columbo organized crime family.

On the 11th of July 1974, a white camper vehicle was seen leaving North Carolina with a load of untaxed cigarettes. Contact with the vehicle was lost and it was subsequently discovered that it had been hijacked during an evening stopover at the Warrenton, Va., truck-stop. The occupants of the vehicle were trussed up and placed in the rear of the vehicle after the shipment had been removed. The smugglers reported their loss to the local sheriff's office and were arrested for illegal transport of cigarettes.

On December 2, 1974, Mr. "E," a driver for a cigarette smuggling operation, was on his way to North Carolina to buy a load of cigarettes when he was accosted by two armed men and relieved of \$15,000 in buy money. Three persons, all known to be involved in contraband cigarette smuggling, responded to the local police office where "E" was being questioned after having reported the incident.

On the night of January 6, 1974, a trailer was stolen from the Epps Company Freight Terminal in Durham, N.C. The trailer contained 1,140 full cases of unstamped cigarettes worth in excess of one-quarter million dollars at current black market prices. This theft is almost proof positive of the highly organized criminal structure involved in contraband cigarettes. Only a sophisticated organization could handle a load of this size, make a profit, and escape detection.

When there were hearings on a similar proposal in 1972, those opposed counseled delay initially because they didn't admit it was a national problem. Then, even then, the testimony suggested that it was more than a New York, or a regional, problem.

So their second argument was that the States really weren't trying. We have done a great deal since then, and so have the other States—with, I might add, some assistance from LEAA. New York State's Cigarette Tax Unit costs us \$1 million a year, and that does not include the work done by the New York City Police and many upstate city police departments. We use stakeout and decoy tactics. We use legal eavesdropping techniques. We have trips to North Carolina.

Our investigators are professionals. Even to take the civil service examination for excise tax investigator, you must have 4 years of full-time paid experience in a field investigative position. Experience in collection, credit checking, guard positions, and so forth, is not qualifying. College study in criminal justice or police science can be credited for up to 3 of the 4 years of experience.

We pay informants. We use a sophisticated stamp machine by Pitney Bowes. Our people are trained. We make legal arrests and use search warrants. We have a base radio communication system and 14 automobiles.



So the argument that the States aren't doing enough certainly doesn't apply any more.

Finally, we have to cope with what I call the "switch game." Those opposed to a Federal cigarette contraband law went to the New York State Legislature this year and asked for a lower cigarette tax because they said that Congress would never pass such a law. And I must say that some of these people are no longer opposed to the bill. Now, they will be coming to Congress counseling delay because "New York might reduce its cigarette taxes." Senators, they will be selling you a "bill of goods."

Please do not delay passage of this bill because you think New York will deal with the problem by cutting its taxes on the assumption that reduced taxes will produce the same or even increased revenues. We cannot take that chance. We have already found out that stepped-up law enforcement in New York City, where the tax totals 23 cents a pack, has resulted in increased bootlegging upstate where the tax is 15 cents a pack. The criminals continue to make enough profit when the tax is 15 cents a pack.

The statistics draw so clear a picture. When we stepped up the law enforcement 2 years ago in New York City for a while, revenues went up. Now our revenues still go up in New York City, and at the same time they are going down upstate.

I hope New York will not surrender to the mob. The only sensible alternative is enforcement of the tax laws in all the States—and to accomplish that we need you.

Senator KENNEDY. Thank you very much for such a powerful statement.

What kind of assurances can you give us that if the Federal Government does take these steps, the States won't relax?

Mr. TULLY. I understand there is precedent for some language in the bill that would prevent the States from doing that, some language that the State would not spend any less for enforcement than they did in any particular year.

I think it is called a maintenance-of-efforts clause. New York would have no objection to that.

Senator KENNEDY. What is your estimate of the scope of the problem? I have heard that one out of every two packs of cigarettes sold in New York City is bootlegged by various crime groups. Is that a reasonable figure?

Mr. TULLY. I think it is a reasonable figure because I think Mr. Donati supports it. I do not. I think it might be exaggerated. I don't know if this comes from a natural optimism. It seems like a terribly high figure.

I think one-third might be more like it.

Mr. Donati made a serious study of the problem and issued a report that became a little famous in New York State known as the Donati report. I believe the report said that one-half of the cigarettes sold in New York City were bootlegged. I am talking about New York City, not New York State.

I would suspect now because of increased law enforcement that it is down from that. But as I said, the percentage of that being sold upstate might be more.

Senator KENNEDY. How effective has the increased law enforcement been?

Mr. TULLY. We could only measure that by revenues. Our revenues have gone up in New York City. Our tax revenues have gone up. I cannot say significantly, but they have somewhat gone up.

As I say, they have gone down in certain other areas upstate. We know it is because of bootlegging because it is right up that route, No. 81, that goes through Pennsylvania. Before we made it hot for them in New York, they would go off perhaps at Scranton, through New Jersey into New York City. Now they go right up into Binghamton and in that area. That is where revenues are down. So you know that is what is doing it.

So, our revenues in the overall have increased, but I am sure that perhaps one-fourth or one-third of the cigarettes sold in New York State are tax evaded.

Senator KENNEDY. Have you made an estimate of the revenue loss of New York State over the last 10 years?

Mr. TULLY. I have not. I buy ACIR recommendations that we are losing about \$100 million a year in city and States taxes plus our sales taxes. I believe the figure is about \$71 million in cigarette taxes, and the balance is in sales taxes. But over the last 15 years, I am not sure.

Senator KENNEDY. You mentioned that there were 25 truck hijackings in 1971. How many have there been in the past year?

Mr. TULLY. There were 40 hijackings in the past year.

Senator KENNEDY. Are these hijackings a large or small percentage of the total activity?

Mr. TULLY. Yes; it is a small percentage of the overall volume of the cigarettes, but it is a significant number of cigarettes. These vans contained an awful lot of cigarettes.

Mr. DONATI. Perhaps the significant factor of the hijackings, Senator, is the violence that is endangered with this crime. It is looked at as a victimless crime by so many sources, but hijackings and murders and other crimes, as the Commissioner pointed out, indicate the type of element we are dealing with.

Senator KENNEDY. What happens to the individuals who are hijacked?

Mr. TULLY. They are usually not murdered. I don't remember them being murdered.

Mr. DONATI. That is correct.

Mr. TULLY. The people who are murdered are the people who step out of line within the crime world.

I had the sad experience of having someone who was perceived to be my informant murdered. That's enough. The person was someone who they thought was my informant, and he was murdered.

Senator KENNEDY. Mr. Donati, would you like to add anything or tell us anything about the efforts and the progress being made in New York?

Mr. DONATI. The efforts we are making at the present time, I think, are probably maximizing what New York State can do, particularly in view of our fiscal situation.

But it goes beyond that. The problem is not as simple as needing more law enforcement officers, for example. There is a temptation to

ask for higher budgets and more men and more vehicles. That is always there, of course. But unfortunately, even if we doubled our law enforcement staff, we would not have that significant an additional impact on the problem because we are at the point of diminishing returns. We are doing about as much as we can with State resources.

As the previous witness indicated, the problems that are engendered, once these people start crossing State lines—where we have to try to track them from the initial conspiracy and source, through the transportation and distribution network, just does not permit an effective single-State action. That is why we are at our maximum point probably.

For various other reasons the problem does not permit combined efforts by the States. The eastern group which was mentioned a little earlier, consists really of the New York effort, because the other Eastern States do not have resources that they can muster for this problem. We have 65 agents, 20 vehicles. Our sister States probably have two or three agents each, whom they can bring to this effort.

As the Commissioner indicated, I think our success has been demonstrated, especially over the past couple of years, in holding the line in New York City which, of course, is the stronghold of the problem. As the Commissioner also indicated, we have had some areas upstate where we have had revenue losses at the rate of \$5 million a year in pockets upstate which is an enormous amount for those areas because we have not been able to concentrate our efforts in those areas.

So, the Federal law enforcement resources which could be brought to bear under this bill would be enormously important from the crime point of view, and from the revenues point of view.

Senator KENNEDY. How do you rate cigarette smuggling in terms of a revenue source for organized crime generally? Is this one of the top four or five sources?

Mr. DONATI. I would say it is in the top half dozen. Probably narcotics, gambling, and prostitution exceed it although there is even a question now whether prostitution provides them with more income. It is certainly within the top half dozen sources of their income. As I think was also previously indicated, one of the most insidious results is that they are getting more and more into legitimate businesses in the cigarette industry.

When we broke the counterfeiting ring that the Commissioner mentioned, last September, we unfortunately had to also arrest four wholesale cigarette dealers who were in cahoots with these people. We have had evidence that more and more retailers are dealing not so much in bootlegging but in counterfeit stamp goods where the profit potential is even higher.

So, the sources of money to organized crime are also undermining legitimate businesses. It is only one short step from the cigarette business to any other legitimate business.

Mr. TULLY. Senator, with regard to your question about organized crime, we have a tape taken of a conversation between an informant and a person who is cooperating with us and agreed to have the recording made. This is an organized crime figure. I think the nationwide scope of this business was demonstrated because, although the tape is not very clear, I think we can play it for you. You will hear the organized crime figure talking to the man he thinks is a legitimate

businessman in the tobacco business. He wants him to front for him in buying tobacco houses, and indicates to him that he could do it. He said it didn't have to be in New York but it could be in New Jersey and in Arizona. He indicates the nationwide scope of the thing.

Mr. DONATI. I handed up a copy of the transcript of what you are about to hear. The conversation took place outdoors. There is some background noise. I might tell you in that regard, while you are listening to this, of the technique that was used for preventing other techniques of eavesdropping here. The people involved in this particular matter once or twice a week would arrive at a parking lot in Queens, and walk around the parking lot and have their conversation, and then get back in their respective automobiles and go back to their origins. They were very, very careful as to how they conducted themselves. But in this case we were able legally to pick up the conversation of which you have a transcript before you.

[Recording played.]

Mr. DONATI. This is an actual conversation between two coconspirators recorded in August 1976, in New York City, by investigators of the New York State Department of Taxation and Finance. They were planning to use counterfeit New York State cigarette tax stamps.

CONSPIRATOR No. 1. But listen to me, listen to me, this game is a lifetime game if you do it right, a lifetime game. When I say it's a lifetime game, this isn't something that's going on this year, or last year, this has been going on for 10 to 15 years, this game. Who does what in the world, I don't know. I don't know, you understand. But-the-if I told you before. If you find a small outfit to buy, a small outfit, let me know. Don't you go in. We'll get someone to go and buy it. You understand?

CONSPIRATOR No. 2. Right.

CONSPIRATOR No. 2. All right now, it don't have to be here in New York, don't have to be here in New York. It could be in Jersey. Jersey is just as good as New York. There is a nickel difference, Jersey is just as good as New York. You could be in Tucson, Arizona, I don't care. You want to go for a trip tomorrow and buy a joint in Tucson, Arizona. You never gotta worry. If you look at the sheet, if you look at the sheet on states, there are maybe six or seven states, or eight states in the whole United States that are less than 15 cents. Fifteen cents is what I'm telling we will do, is a hell of a number.

Mr. DONATI. That is probably the most eloquent testimony today.

Mr. TULLY. Senator, I would point out that he says 15 cents. That's an awful lot of States. I think that is a majority of the States. If he can make a profit with 15 cents, then he is really into something. I didn't know we were going to get into these visual aids, but we have this machine here.

[Machine shown again.]

Mr. TULLY. The man who made this machine received \$5,000 for making it and he was later murdered. We think it is because he knew too much because he made this in 10 different States. This was his New York item [indicating].

Senator KENNEDY. Does that machine counterfeit the tax stamps?

Mr. TULLY. Yes.

Senator KENNEDY. Does it do a good job?

Mr. TULLY. Yes, a very good job.

The machines we have register like an adding machine, and as the cigarettes go through it, it stamps and counts them. Then, of course, the tobacco house makes a report to us and we can always check the machines. Of course, there is no addition going on in these machines.

Another thought I had while we were talking about this was this.



In talking of the scope of the problem, in the interest of organized crime in this and their effectiveness and the fact that they almost monopolize it, I think you have heard Owen Clark, the Commissioner in Massachusetts. I was talking to him about the problem one day and I said, "Well, I always have a hesitation about talking about the ease with which it is distributed, especially if the word gets around." He said, "Don't worry about it, if the law doesn't get those independent operators, the underworld will."

That is true. He has seen a pattern in Massachusetts where once it used to be the individual operator, maybe the neighborhood "bad boy" or something like that and he would go into this as well. That pattern has ended. It is now the organization boys who now take care of the whole thing.

Senator KENNEDY. We thank you very much for your testimony. Mr. Davis, you may proceed.

**STATEMENT OF REX D. DAVIS, DIRECTOR, BUREAU OF ALCOHOL, TOBACCO, AND FIREARMS, U.S. TREASURY DEPARTMENT, ACCOMPANIED BY MARVIN DESSLER, CHIEF COUNSEL, BUREAU OF ALCOHOL, TOBACCO, AND FIREARMS**

Mr. DAVIS. Thank you, Mr. Chairman. I have a very short opening statement which I would like to make.

Senator KENNEDY. Please proceed.

Mr. DAVIS. Mr. Chairman and members of the subcommittee, I am Rex D. Davis, Director of the Bureau of Alcohol, Tobacco, and Firearms. I am accompanied by Mr. Marvin Dessler, chief counsel for the Bureau. We also have additional expert witnesses if they should be needed by the committee.

The information I present today is of a technical or advisory nature and does not represent any endorsement of pending legislation by the Department of the Treasury.

The Bureau's involvement with cigarettes presently is to assure the collection of Federal excise taxes. In this respect, the Bureau collects \$2.4 billion annually in various tobacco taxes. These taxes are paid by the manufacturer based on shipments from the factory, after which involvement by the Bureau ceases.

Presently, the illicit interstate traffic in cigarettes to evade State and local taxes does not violate any Federal law enforced by ATF. S. 1487 would alter that and involve the Federal Government if the amount of cigarettes shipped interstate was more than 20,000.

To begin this discussion, it is necessary to make some evaluation as to the size, scope, and nature of cigarette smuggling. Simply put, the cigarettes are purchased in States which have low State excise taxes on cigarettes, and transported to States which have higher taxes. There, the cigarettes are sold on a black market. In some cases, counterfeit State and local tax stamps are used to mark the cigarette packages to make them appear legitimate.

Since ATF has no jurisdiction over the interstate transportation of cigarettes in avoidance of State taxes, we have little direct information on the nature or extent of these smuggling operations. Consequently, these comments and estimates are based primarily on information from the Advisory Commission on Intergovernmental

Relations, the Interstate Revenue Research Center, and the Eastern Seaboard Interstate Cigarette Tax Enforcement Group.

As I said, ATF collects \$2.4 billion annually in tobacco taxes. The total in tobacco excise taxes collected by the States is \$3.4 billion. The Advisory Commission estimates that annual losses to the States from cigarette smuggling is \$337 million.

The Advisory Commission lists 17 States which it estimates lose more than 8 percent of their cigarette tax revenues, apparently through organized cigarette bootlegging. These States are widely dispersed. For example, Arizona, Washington, and Texas are in the West; Minnesota, Wisconsin, and Illinois are in the central area; Arkansas, Tennessee, and Florida are in the South; and Pennsylvania, New York, and Massachusetts are in the Northeast.

The other States identified by the Advisory Commission as having a serious bootlegging problem are Maine, Alabama, Ohio, New Jersey, and Connecticut. The Commission also identifies seven other States which have a moderate revenue loss which would be less than 8 percent. These States are New Mexico, Nebraska, Iowa, Missouri, Michigan, West Virginia, and Georgia.

There are only three States presently considered to be the prime source for bootleg cigarettes because of their low tax rates. These are Kentucky, North Carolina, and Virginia. There are several other States which are potential sources.

Thus, if enforcement efforts are successful in shutting off the existing sources in these three States with the lowest taxes, there are other States with only moderate taxes from which the smugglers could still obtain cigarettes at a cost well below the sale price in the highest tax States. Consequently, for an enforcement effort to have a significant and long-lasting effect, it would be necessary to concentrate on the present sources of supply and distribution, and to anticipate and preclude a shift in the supply source.

Based on the Advisory Commission's evaluation of the scope of the cigarette smuggling problem, the Bureau has estimated the law enforcement resources needed to cope with the problem nationwide, assuming a sufficient level of State enforcement. The cost would be \$3.8 million which would include all manpower and equipment costs. This estimate does not include consequent prosecutorial and judicial costs.

Senator KENNEDY. Do you think you could set up a Federal interdiction program for \$3.8 million?

Mr. DAVIS. Yes.

Senator KENNEDY. We are talking about \$300 to \$400 million that are being lost by the States at the present time. That's a pretty good cost/benefit ratio in terms of law enforcement.

Mr. DAVIS. Yes; that is about 1 percent of the tax losses, as we understand it.

Senator KENNEDY. I don't know many programs that we have passed in the Congress that have had that kind of cost-effectiveness ratio. The Federal law enforcement effort would affect both the State tax revenue aspects of the problem, and the involvement of organized crime. Equally important is the effect such an effort would have on the small businessmen and their ability to survive.

Mr. DAVIS. Of course, this cost is based on the existing law enforcement agency. In other words, if you started up a completely new effort, the cost would be greater.

Senator KENNEDY. Would you give us a breakdown and submit that as a part for the record?

Mr. DAVIS. Yes.

[Material supplied follows:]

Salaries:	Cost
100 GS-7 positions (includes personnel benefits)-----	\$17,785,000
Equipment:	
85 vehicles @ \$5,200-----	442,000
4 communications repeater systems @ \$5,000-----	20,000
85 mobile radios @ \$1,600-----	136,000
4 radio base station systems @ \$7,200-----	28,800
50 portable radios @ \$1,400-----	70,000
2 electronic surveillance kits @ \$3,000-----	6,000
100 handguns @ \$131-----	13,100
100 handcuffs @ \$15-----	1,500
75 binoculars @ \$45-----	3,375
2 night vision scopes @ \$2,900-----	5,800
50 cassette recorders @ \$114-----	5,700
1 leased surveillance aircraft @ \$20,000-----	20,000
Purchase-of-evidence funds-----	135,000
Relocation of experienced special agents-----	350,000
Rental space: 135 sq. ft. per person @ \$10-----	135,000
Communications, telephone-----	30,000
Clerical support: 1 per 6 agents, GS-4 @ \$8,900 x 16-----	142,400
Travel expenditures:	
100 special agent positions @ \$5,000-----	500,000

Since all investigations of contraband cigarettes would involve interstate travel, the usual allocated amount of \$2,500 per year for travel has been increased by 100 percent.

Mr. DAVIS. In addition to making it a Federal offense to transport or possess non-State-tax-paid cigarettes, most, but not all, of the bills would also require dealers to keep records of all sales of 20,000 or more cigarettes. Based on our experience with the illegal liquor raw materials program and the Gun Control Act, we consider the recordkeeping provision and the attendant authority to examine these records essential to effective enforcement.

This recordkeeping feature would be important in supplying investigative leads, and would primarily apply to suppliers in the low-tax States who are often not directly violating any laws of the State in which they operate, because the cigarette tax has been paid in that State.

Since the requirement would only apply to sales of more than 20,000 cigarettes at a time—that is, more than 100 cartons—it would not apply to ordinary retail sellers but only to those who are clearly wholesalers. Further, the recordkeeping provisions likely would not cause additional records to be kept by legitimate wholesalers, since they already must keep records of transactions for Federal income tax and State cigarette tax purposes.

Besides providing investigative leads, the recordkeeping provisions should also make more vulnerable to Federal prosecution those suppliers who fail to properly document transactions in which they are operating in conspiracy with the transporters.

Mr. Chairman, I believe these points are the most salient from an enforcement standpoint should an anticigarette smuggling bill be passed. I am prepared to answer any further questions.

Thank you.

Senator KENNEDY. To what extent is the growth of cigarette bootlegging due to the lack of attention by the States? To what extent are

the States handicapped because of the failure of existing legislation? Is there any accountability at the present time?

Mr. DAVIS. From my knowledge of the efforts by the various States in this area, they have done—as the previous gentleman testified—about all they can under the existing circumstances. I am sure the committee is aware that there have been special funding efforts by the Federal Government and LEAA on the regional approach.

As I understand the problem, there are really two primary handicaps that the States face. One of them, of course, is the interstate nature of this traffic. There is a lack of any individual State in having jurisdiction into source States.

Of course, by the same token that means that they are also handicapped in obtaining intelligence as to the nature of the traffic and the sources of supply and the customers and people who are operating in the trafficking rings.

Senator KENNEDY. Do you feel that at present the States are unable to deal effectively with this particular problem? Can you give us any estimate of the growth potential of this problem if nothing further is done by the Federal Government? Would it continue to grow?

Mr. DAVIS. Certainly, in my personal opinion it would. More than likely it would grow because I am reasonably certain that there will be more demands for tax revenue. Certainly as the gap widens between the States, there would be additional incentives for organized criminal groups to become involved in the trafficking.

Senator KENNEDY. Has ATF made any effort to collect intelligence in this area in the past?

Mr. DAVIS. No, sir, we have not. It has not been within our jurisdictional responsibility, and we have had no incentive to do so.

Senator KENNEDY. Have you picked up any information to indicate the extent of organized crime involvement?

Mr. DAVIS. Not directly, but certainly we think that the avenues presented in the various studies and the various efforts is impressive that organized crime involvement does exist. Certainly the size of some of the transactions that have come to our attention, and some of the seizures that we have made would indicate that there is a tremendous margin of profit involved.

Senator KENNEDY. Have you been able to identify the corridors in the country where this traffic takes place?

Mr. DAVIS. Yes, to a large degree. Certainly along the eastern coast between the southern tobacco-producing States and the Northeastern States is a corridor. Then, there is the Central corridor from the States of Kentucky, Tennessee, and in that area up into the Northern States in the central part of the country.

Then, of course, there is another major one in the West primarily into the State of Washington which has a high State excise tax on cigarettes.

These are just the major ones. There are other more localized traffic routes.

Senator KENNEDY. What is the basis for your estimate that it would cost \$3.8 million to set up an effective Federal program?

Mr. DAVIS. It is primarily based on the 100-agent man-years. We feel that with that amount of man-years the problem could be effectively dealt with. Of course, the cost includes such things as equipping these people and on down the line.

Senator KENNEDY. How many agents would that be?

Mr. DAVIS. In this kind of program it would be 100 new agents.

I might point out that any Federal law enforcement organization which might be given responsibility for this problem would not use just 100 agents for this purpose. In other words, all of the agents of the particular agency would be available. In other words, there would not be a cadre of specialists for this purpose. But the total number of agents that would be available at any one time to deal with the problem would be that number.

Senator KENNEDY. How long would it take to set up this effective program?

Mr. DAVIS. On the basis of an in-place Federal agency given the responsibility, the program could start immediately because the experienced agents could be devoted to the program immediately.

Then, of course, any new agents which were brought in would go through the training process and would then help to fill in behind the agents that were being diverted from other areas.

Senator KENNEDY. We want to thank you very much for your helpful testimony. We will keep the record open for a reasonable period of time to receive additional comments.

The subcommittee stands adjourned.

[Whereupon, at 12:15 p.m., the subcommittee adjourned.]

S. 1487, 95th Cong., 1st Sess.

A BILL To eliminate racketeering in the sale and distribution of cigarettes, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

#### STATEMENT OF FINDINGS AND PURPOSE

SECTION 1. (a) The Congress finds that—

(1) there is a widespread traffic in cigarettes moving in or otherwise affecting interstate or foreign commerce, and that the States are not adequately able to stop the movement into and sale of such cigarettes in violation of their tax laws through the exercise of their police power;

(2) there is a causal relationship between the flow of cigarettes into interstate commerce to be sold in violation of State laws and the rise of racketeering in the United States;

(3) organized crime has realized hundreds of millions of dollars annually in profits from the sale of such cigarettes in violation of State laws, and has channeled such profits into other illicit activities;

(4) a sharply expanded Federal role in the fight against cigarette smuggling is essential if there is to be an effective law enforcement effort against cigarette smuggling, since the interstate nature of the crime places individual States at too great a disadvantage to handle these problems effectively;

(5) certain records maintained by dealers in cigarettes will have a high degree of usefulness in criminal, tax, and regulatory investigations.

(b) It is the purpose of this Act to provide a timely solution to a serious organized crime problem and to help provide relief to many cities and States.

Sec. 2. Title 18, United States Code, is amended by inserting immediately after chapter 59 thereof the following new chapter:

#### CHAPTER 60.—CIGARETTE TRAFFIC

"Sec.

"1285. Definitions.

"1286. Unlawful acts.

"1287. Recordkeeping and reporting.

"1288. Penalties.

"1289. Effect on State law.

"1290. Enforcement and regulations.

#### "§ 1285. Definitions

"As used in this chapter:

"(a) The term 'cigarette' means—

"(1) any roll of tobacco wrapped in paper or in any substance not containing tobacco, and

"(2) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in paragraph (1).

"(b) The term 'contraband cigarettes' means a quantity in excess of twenty thousand cigarettes, bearing no evidence of the payment of applicable State cigarette taxes in the State where they are found, and which are in the possession of any person other than—

"(1) a person holding a permit issued pursuant to chapter 52 of title 26, United States Code, as a manufacturer of tobacco products or as an export warehouse proprietor, or a person operating a customs bonded warehouse pursuant to section 1811 or 1155 of title 19, United States Code, or an agent of such person;

"(2) a common or contract carrier: *Provided, however,* That the cigarette are designated as such on the bill of lading or freight bill;

"(3) a person licensed or otherwise authorized by the State where the cigarettes are found to deal in cigarettes and to account for and pay applicable cigarette taxes imposed by such State; or

"(4) an officer, employee, or other agent of the United States, or its departments and wholly owned instrumentalities, or of any State or any department, agency, or political subdivision thereof, having possession of cigarettes in connection with the performance of his official duties.

"(c) The term 'common or contract carrier' means a carrier holding a certificate of convenience or necessity or equivalent operating authority from a regulatory agency of the United States or of any State or the District of Columbia.

"(d) The term 'State' means any State, or the District of Columbia, which requires a stamp, impression, or other indication to be placed on packages or other containers of cigarettes to evidence payment of cigarette taxes.

"(e) The term 'dealer' means any person who sells or distributes in any manner any quantity of cigarettes in excess of twenty thousand in a single transaction.

"(f) The term 'Secretary' means the Secretary of the Treasury or his delegate.

"(g) The term 'person' means any individual, corporation, company, association, firm, partnership, society, or joint stock company.

#### "§ 1286. Unlawful acts

"(a) It shall be unlawful to ship, transport, receive, or possess contraband cigarettes.

"(b) It shall be unlawful to knowingly make any false statement or representation with respect to the information required by this chapter to be kept in the records of a dealer.

#### "§ 1287. Recordkeeping and reporting

"Each dealer shall maintain such records of shipment, receipt, sale, or other disposition of cigarettes at such place, for such period, and in such form as the Secretary may by regulations prescribe. Dealers shall make such records available for inspection at all reasonable times, and shall submit to the Secretary such reports and information with respect to such records and the contents thereof as he shall by regulations prescribe. The Secretary may enter during business hours the premises (including places of storage) of any dealer in cigarettes for the purpose of inspecting or examining (1) any records or documents required to be kept by the dealer, and (2) any cigarettes kept or stored by the dealer at such premises.

"§ 1288. Penalties

"(a) Whoever violates any provision of this chapter or regulations promulgated thereunder shall be sentenced to pay a fine of not more than \$10,000, or to be imprisoned for not more than two years, or both.

"(b) Any contraband cigarettes involved in any violation of the provisions of this chapter shall be subject to seizure and forfeiture, and all provisions of the Internal Revenue Code of 1954 relating to the seizure, forfeiture, and disposition of firearms, as defined in section 5845(a) of that Code, shall, so far as applicable, extend to seizures and forfeitures under the provisions of this chapter.

"§ 1289. Effect on State law

"Nothing in this chapter shall be construed to affect the concurrent jurisdiction of a State to enact and enforce State cigarette tax laws, to provide for the confiscation of cigarettes and other property seized in violation of such laws, and to provide penalties for the violation of such laws.

"§ 1290. Enforcement and regulations

"The Secretary shall enforce the provisions of this chapter and may prescribe such rules and regulations as he deems reasonably necessary to carry out the provisions of this chapter."

Sec. 3. (a) Except as provided in subsection (b), the provisions of chapter 60 of title 18, United States Code, shall take effect on the first day of the first month which begins more than one hundred and twenty days after enactment.

(b) The following sections of chapter 60, title 18, United States Code, shall take effect on the date of enactment of this Act: Sections 1285, 1286(a), 1288, 1289, and 1290.

Sec. 4. The title analysis of title 18, United States Code, is amended by inserting immediately below the item relating to chapter 59 the following:

"60. Cigarette Traffic----- 1285."

Sec. 5. (a) Section 1(b) of the Act of August 9, 1939 (ch. 618, 53 Stat. 1291), as amended by (1) striking out "or" at the end of paragraph 2, (2) striking out the period at the end of paragraph 3 and inserting in lieu thereof "; or", and (3) adding after paragraph 3 the following new paragraph 4 to read as follows:

"(4) Any cigarettes, with respect to which there has been committed any violation of any provision of chapter 60 of title 18 or any regulation issued pursuant thereto."

(b) Section 7 of the Act of August 9, 1939 (ch. 618, 53 Stat. 1291), as amended (49 U.S.C. 787), is amended by (1) striking out "and" at the end of subsection (e), (2) striking out the period at the end of subsection (f) and inserting in lieu thereof "; and", and (3) adding after subsection (f) the following new subsection (g) to read as follows:

"(g) The term 'cigarettes' means 'contraband cigarettes' as now or hereafter defined in section 1285(b) of title 18."

U.S. SENATE,  
COMMITTEE ON THE JUDICIARY,  
Washington, D.C., November 25, 1977.

DEAR —: On October 21, 1977, the Subcommittee on Criminal Laws and Procedures held a hearing chaired by Senator Edward M. Kennedy on S. 1487, a bill aimed at eliminating racketeering in the sale and distribution of cigarettes.

Due to the many pressing matters before the Senate this session we have been unable to schedule additional hearings. However, the Subcommittee would appreciate having your recommendations about this important bill in a prepared statement to be included in the hearing record by the Subcommittee.

In addition to the effect cigarette bootlegging has had upon the States, we would like for you to address the extent and nature of organized crime involvement, the necessity for a Federal law enforcement effort, the type of penalty which should be imposed, and the appropriate cutoff limit of transported cigarettes. Any other information you may wish to supply would be welcomed. A copy of S. 1487 is enclosed.

In order that the Subcommittee may have time to study your comments and recommendations, your statement should be sent on or before December 15, 1977.

If the staff can assist you in any way, please contact Paul Summitt (202-224-3281) or Robert M. McNamara, Jr. (202-224-7488).  
Sincerely,

Enclosure.

JOHN L. MCCLELLAN, *Chairman.*

STATEMENT BY LOUIS H. EHRLICH, JR., CHAIRMAN, NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS

My name is Louis H. Ehrlich, Jr. I am Chairman, Rothenberg & Schloss, Inc., Kansas City, Missouri, and Chairman, Committee on Legislation and Taxation, National Association of Tobacco Distributors. This statement is presented on behalf of the National Association of Tobacco Distributors, whose membership provides a nationwide network for the wholesale distribution of tobacco, confectionery and kindred consumer products to over a million retail outlets. The extensive mix of products distributed includes, but is not limited to, cigarettes, cigars, pipes and smokers' accessories.

My company has not carried cigarettes since the beginning of World War II, and other tobacco products per se since January 1, 1976. As a private citizen, I am concerned for this country's welfare being undermined by organized crime penetration into retail cigarette sales through illicit cigarette bootlegging in interstate commerce.

With this background information, and at the behest of the Wholesale Tobacco Industry and its retail customers, we wish to urge expeditious Congressional action to inhibit the growing cigarette bootlegging problem by enacting S. 1487 making it a federal offense to transport contraband cigarettes in interstate commerce.

It is estimated that cigarettes bootlegging is costing the 50 states and local taxing authorities in excess of \$400 million annually in tax revenue. In addition, legitimate business (the tobacco wholesalers and retailers) is sustaining losses in the millions of dollars, and find it impossible to compete with organized crime paying no taxes and not subject to normal business expenses.

The recent report of the New York State Special Task Force on Cigarette Bootlegging and the Cigarette Tax includes the following statement. I quote:

"Contraband cigarettes in the past have been retailed mainly through businesses which don't normally deal in tobacco products, such as beauty parlors, barber shops, and other such business places, as a convenience to their customers and an added source of revenue for themselves—and even, as another example, from the back of a station wagon at a construction site. In recent months, however, the State has discovered that these untaxed cigarettes are being increasingly sold in legitimate retail outlets. In other words, more and more business men and women, who are law-abiding in other respects, have become law-violators by evading the cigarette tax. Moreover, they are assisting in robbing the State of much-needed revenue at the same time that they are becoming accomplices of big-time racketeers and small-time hoodlums. Perhaps most tragic, the legitimate retailers who have become tax-evaders by selling contraband are subjecting themselves to arrest and criminal prosecution with resultant disgrace to their families as well as themselves."

Manufacturers' trucks have been hi-jacked, resulting in heavy losses to them and an impact on their insurance rates. These hi-jacks are professional in nature and are believed to be the efforts of organized crime. Organized crime does not care whether the cigarette packs are stamped or without tax indicia, as they have the outlets to dispose of them.

Because of the increase in hi-jacking and wholesale thefts, to maximize the illicit profits in the hi-tax-rate States, motor carriers are turning down legitimate cigarette shipments, and insurance rates of licensed cigarette warehouses are skyrocketing.

Investigations, surveillances, and informants have resulted in bringing to the attention of the States that the violators are becoming more sophisticated and move their operations frequently. Their sources of supply, routes of travel, places of reloading, storage warehouses, and sources of disposing of cigarettes are constantly changing, which makes for more difficult investigations and apprehensions.



It is said the major cigarette wholesaler today in the New York City area is the underworld accounting for over half of all cigarettes sold with a resulting tax revenue loss of \$85 million annually. Gross profit of \$60,000 is estimated to be illegally realized from a tractor trailerload of contraband cigarettes sold in the black market of the Eastern Seaboard.

You may ask isn't this a localized problem for New York City and the Eastern Seaboard. The answer is definitely "NO". What has happened in New York on a major scale has spread to the other northeastern states, the southern states, particularly Florida, and the midwestern states. Missouri, my home state with 9 cents tax, is estimated to be losing \$1-\$6 million annually in cigarette tax revenue from bootlegging out of North Carolina and Kentucky.

The Special Investigations Bureau responsible for the investigation of tax frauds has 12 agents: 6 in St. Louis, 4 in Kansas City, 1 in Jefferson City and 1 in Cape Girardeau near the Kentucky border. The major part of its investigation is sales, income, and motor fuel tax frauds, but only 20 percent of its effort is being devoted to the investigation of cigarette bootlegging.

Cigarette bootlegging will continue to spread if states continue to raise cigarette taxes to meet the need for added revenue and the tax differential continues between states such as North Carolina 2 cents, Virginia 2½ cents, Kentucky 3 cents and Indiana 6 cents. Unfortunately the states do not have the manpower nor the revenue to control its growth nor provide adequate law enforcement. Last month CBS on "60 Minutes" and NBC on the "Today Show" dramatically showed the extent of cigarette bootlegging and the state inability to cope with it.

Three possible solutions have been suggested:

1. State Tax Uniformity—With the 50 sovereign states each executing its rights based on fiscal needs in the levy and imposition of cigarette taxes, there is no likelihood for state tax uniformity—Legislative bills have been introduced both in Kansas and New York to reduce the cigarette tax. In Kansas the bills never got out of Committee and in New York, where tax relief is sorely needed, defeated despite the offer of wholesale tobacco distributors to set up an escrow fund of \$18 million to offset any revenue loss from a reduced tax.

2. The Federal Government to pre-empt state cigarette taxation and establish a Federal Uniform Tax Rate with revenue sharing to the states and indirectly to local tax authorities. For Congress to take away from the states their right to cigarette taxation is wishful thinking.

3. To make cigarette bootlegging in interstate commerce a federal offense which will call for Congressional action since this has become a state-federal problem.

The Advisory Commission on Intergovernmental Relations (ACIR) has made a thorough study of "Cigarette Bootlegging" and following its hearing at which I testified last December released its report in May. I quote in part from its conclusions:

"That large state cigarette tax differentials and the difficulty in controlling the interstate flow of contraband cigarettes have created an environment conducive to the large scale involvement of organized crime in cigarette bootlegging".

The extent of this involvement is shown by the following incident recently related to me. A well dressed individual came into the office of an established California wholesaler and offered to purchase for cash a substantial quantity of unstamped cigarettes to be shipped through the Panama Canal to a New York State destination. The sale was not consummated as the State of California would not grant a license for it indicating underworld implications.

And again referring to the ACIR report, I quote in part from its recommendations:

In order to enhance the effectiveness of cooperative State and Federal enforcement efforts, the Congress should give early and favorable consideration to legislation prohibiting the transportation of contraband cigarettes in interstate commerce."

The Kansas City Times in a September 5 editorial commented on the ACIR report and called for legislation making cigarette bootlegging a Federal offense, copy attached.

Time Magazine concluded in its recent cover story "The Mafia—Big, Bad and Booming" that there must be an end to American tolerance for any kind of organized crime. The longer the delay in the enactment of legislation to make contraband cigarettes in interstate commerce a Federal offense, the more difficult it will become to uproot the underworld involvement.

We therefore conclude that cigarette bootlegging because of its complex nature involving organized crime cannot be controlled nor eliminated at the state level and, as recommended by the Advisory Commission on Intergovernmental Relations, Federal Contraband Legislation as provided in S. 1487 should be expeditiously enacted.

[From the Kansas City Times, Sept. 5, 1977]

#### BAN CIGARETTE SMUGGLING

The bootlegging of cigarettes has not raised much public concern mainly because, we suspect, the full impact and scope of this criminal activity has not undergone a comprehensive analysis.

Now that rather formidable task has been completed by the Advisory Commission on Intergovernmental Relations (ACIR), a permanent, national organization established by Congress in 1959 to report on problems that affect the various levels of government. The findings were discussed in detail in a recent news story. Essentially, however, the smuggling of cigarettes is depriving the states of an estimated \$337 million a year in revenue and has become the second largest source of income, next to narcotics, for organized crime. The cigarettes are transported from low-tax states, such as North Carolina where the tax is 2 cents a package, to areas where the levy is much higher. In New York City, for example, the tax is 23 cents a pack.

This illicit traffic in cigarettes cannot be considered a victimless crime. The ACIR sums it up this way: "The consequences of organized smuggling, however, extend beyond the loss of government revenues. Taxpayers pay higher taxes or receive fewer services, cigarette wholesalers and retailers are driven out of business and jobs are lost, political and law enforcement officials are corrupted, trucks are hijacked and warehouses raided, and people are injured and even killed."

Estimated losses from bootlegging are \$6 million a year in Missouri and \$1.6 million in Kansas.

Currently cigarette bootlegging is not a federal crime. State laws, where they exist, are difficult to enforce because the merchandise is bought in one area and sold in another. The attorney general of North Carolina, for example, recently noted that there is no law violation when smugglers purchase cigarettes in his state. The problem, he added, occurs where the cigarettes are sold illegally.

The North Carolina official is correct. But it would be wrong to assume that citizens of North Carolina, or any other state, do not suffer, directly or indirectly, from the contraband cigarette market.

Legislation to outlaw smuggling has been introduced in Congress. Hearings are expected this year on a bill that would make bootlegging a federal offense. An effective statute would halt the loss of taxes and at the same time cut off income from the criminal element. That would be to the good and should be pursued diligently in Washington.

STATEMENT SUBMITTED TO THE SUBCOMMITTEE ON CRIMINAL LAWS AND PROCEDURES OF THE SENATE JUDICIARY COMMITTEE BY THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS AND THE NATIONAL TOBACCO TAX ASSOCIATION IN SUPPORT OF S. 1487, A BILL TO ELIMINATE RACKETEERING IN THE SALE AND DISTRIBUTION OF CIGARETTES

The National Association of Tax Administrators, an organization of the tax administrators of the revenue departments of the 50 states, and the National Tobacco Tax Association, an organization of tobacco tax administrators in the revenue departments of the 50 states, express their full support of S. 1487, the Bellmon-Anderson bill.

Federal contraband legislation, as represented by S. 1487, has the full support of state governments. The National Association of Tax Administrators and the National Tobacco Tax Association, at their annual meetings over a span of years, have unanimously adopted resolutions urging Congress to enact legislation which would prohibit the transportation of cigarettes across state lines for the purpose of evading state taxes. The National Governors' Association, in 1977, also called upon Congress to enact contraband cigarette legislation. This

year, the Advisory Commission on Intergovernmental Relations, after an extensive study of cigarette bootlegging, strongly recommended that Congress enact such legislation.

*Cigarette bootlegging—a wholly interstate problem*

Cigarette bootlegging is wholly an interstate problem which arises from the fact that under our system of government, each state determines its own tax rates and makes this determination on the basis of financial, economic, political and other factors. No state has control over another state's tax rates, and the disparity of state cigarette tax rates which has given rise to cigarette bootlegging is entirely a product of our federal system.

The fact that interstate tax problems have become especially intense is attributable to:

- (1) The ease with which cigarettes can be transported across state lines.
- (2) The price consciousness of cigarette consumers. Historically smokers have always been highly responsive to markets offering cigarettes at less than the prevailing price.
- (3) The special appropriateness of cigarette taxes as a source of marginal state revenues, stemming from the fact that cigarettes are a product whose use is discouraged by federal government—the U.S. Surgeon General, Congress, and the Federal Trade Commission.

- (4) The impact of the U.S. Surgeon General's findings on the relationship of health and smoking.

With respect to the last, the disparity in state cigarette tax rates, which had always existed to a limited degree, was expanded sharply after the issuance of the Surgeon General's report in the mid-1960's. This occurred because many states considered the Surgeon General's findings that smoking was deleterious to health a valid and convincing basis for increasing cigarette taxes more sharply than ever before, while other states, notably the tobacco producing states, kept cigarette taxes at their former level.

In 1965, when state cigarette tax rates ranged from 2 to 9 cents per pack, there was no cigarette bootlegging of any significance. Currently, the cigarette tax rates range from 2 cents in North Carolina to a combined state-city rate of 23 cents per pack in New York City, while 21 states have rates in excess of 12 cents per pack. Thus, cigarette bootlegging stems from the fact that illicit operators can use the low tax tobacco-producing states as a source of supply for potential profits of up to \$2.10 per carton, based solely on tax differentials in the states which raised their rates sharply after the issuance of the Surgeon General's report.

*Limitations on the States' capacity to deal with cigarette bootlegging*

Without federal assistance, state revenue department efforts, no matter how much they may be expanded, cannot be effective against cigarette bootlegging because:

- (1) Cigarette bootlegging is completely an interstate operation and the authority of the state enforcement officials does not extend beyond the borders of their respective states.
- (2) The widespread presence of organized crime makes bootlegging a police problem of peculiar complexity rather than a tax administrative problem.

State tax enforcement personnel are auditors and investigators, rather than law enforcement officers, and they are further handicapped by the geographic limitations of their authority. State revenue departments have given increased emphasis to law enforcement efforts because of bootlegging, but they are limited in these efforts by budgetary considerations and by the secondary position of cigarette taxes in state revenue systems.

The states' major taxes—sales taxes and income taxes—are administered at less than two percent of total collections. It would be difficult for a state revenue department to justify incurring costs in an amount equivalent to a double digit percentage of cigarette tax collections in order to cope with a police problem that is wholly interstate in origin, particularly when the results of such an effort could only be fractionally effective.

The states have expanded their efforts in combatting bootlegging by adding to their investigative staffs, and in both the eastern seaboard and in the mid-west, by forming co-operative surveillance groups in an attempt to deal with the interstate character of cigarette bootlegging. The states recognize that both these individual and collective efforts are vastly less effective than would be a

comparable effort by a single federal enforcement agency which could operate on a national basis and which could draw upon its extensive experience in dealing with interstate crime.

*Presence of organized crime*

The presence of organized crime in cigarette smuggling on the eastern seaboard has been documented in the Advisory Commission on Intergovernmental Relations' report on cigarette bootlegging, in testimony presented by James H. Tully, Jr., Commissioner of Taxation and Finance, New York, to the hearing on S. 1487 conducted by Senator Kennedy on October 21, 1977, in testimony presented to the ACIR by J. Robert Murphy, Deputy Director of the New Jersey Division of Taxation and past President of the National Tobacco Tax Association and by Edward Lorch of the New York City Police Department. This testimony has emphasized that cigarette smuggling is a major source of revenue for organized crime. ACIR has placed the state and local governments' revenue loss from cigarette tax evasion at \$400 million annually.

State revenue departments have pointed out that this figure is far in excess of the estimates of revenue loss in 1972, the first year in which Congress gave serious consideration to the enactment of a contraband cigarette bill. Because the bill failed to pass at the time, cigarette bootlegging has been able to grow at an alarming rate in the absence of the only means for effectively combatting these illicit operations—the presence of a federal enforcement agency administering an effective federal law directed specifically at cigarette bootlegging. Without federal enforcement, bootleggers have little fear of being apprehended and convicted.

The state revenue departments point out that, if there is further delay in instituting an effective federal anti-bootlegging effort, organized crime operations will continue to expand rapidly. This will occur because the sources of bootleg cigarettes and the bootleg operations are well established, and the potential market for bootleg cigarettes is just being tapped. The profit incentive in cigarette bootlegging is so large as to attract a continuous entry of criminal elements into the activity.

Cigarette consumers are highly price conscious because smoking is an everyday process, and they will gravitate to new markets for bootleg cigarettes—factories, service stations, barber shops, etc.—as they become available. The marketing of bootleg cigarettes by licensed distributors emerged during the past year in Illinois and New York. Here again, the profit incentive may be expected to expand these illicit operations if federal enforcement is not provided.

What has happened in the northeast is a prototype of what can be expected to happen elsewhere in the country. In the east, cigarette bootlegging was begun by small individual operators, who trafficked cigarettes between North Carolina and the northeastern states.

As these operations became more extensive and profitable, organized crime entered the field. At the present time, midwest bootlegging is conducted largely by individuals whose criminal operations are conducted on a routine basis. As these operations increase, it can be expected that the syndicated crime presence will become more predominant as it did on the eastern seaboard. There is little cigarette bootlegging in the western states because cigarette tax rates are more uniform there. However, if several western states raise their rates to the northeastern level—and this is possible because of state revenue needs—bootlegging could emerge suddenly.

*S. 1487's penalty and cutoff limit of transported cigarettes*

S. 1487 corresponds to the contraband cigarette bill drafted by the National Tobacco Tax Association with the technical advice of the Bureau of Alcohol, Tobacco and Firearms, for consideration of the state revenue department in communicating their concerns to their Congressional representatives. The bill was circulated as a draft subject to changes that might result from Congressional review.

In drafting the provisions, the underlying considerations with respect to penalty provisions and the provisions on the appropriate cutoff limit of transported cigarettes, concerning which the Subcommittee on Criminal Laws and Procedures has raised questions, were as follows.

*Penalty provisions.*—In the draft, consideration was given to the imposition of heavier penalties than those now provided in the bill. The decision to provide the penalties in the bill—a fine up to \$10,000, imprisonment up to two years, and seizure of the contraband cigarettes—was in response to an expression of



views that these penalties corresponded to those in other federal laws, and that the courts might be expected to take an unfavorable attitude towards heavier penalties. It was also pointed out that if a court wished to impose heavier penalties, the bill would permit it to do so on a multiple count basis, so that substantially heavier penalties can be instituted under the bill's provisions.

*Cutoff limit of transported cigarettes.*—In the bill, the term "contraband cigarettes" is defined to mean a quantity in excess of 20,000 cigarettes. In arriving at the figure, the following factors were considered:

(1) The 20,000 figure would effectively negate any claim by an individual that he has purchased the cigarettes for his personal use.

(2) The federal courts would not be expected to look with favor on prosecutions involving the small revenues losses attributable to quantities of less than 20,000 cigarettes. (As examples, under existing laws, for the highest cigarette tax rate involved—the combined New York State-New York City 23 cents per pack tax rate—the revenue loss on a load of 20,000 bootleg cigarettes would be \$230; for Massachusetts, it would be \$210; and in New Jersey, \$190).

(3) It was suggested that the federal enforcing agency would be reluctant to employ needed personnel on violations involving smaller state revenue losses, in view of the uncertainty over the courts' attitude towards cases involving such amounts.

(4) Except where relatively short trips across state lines are involved, 20,000 is perhaps the minimum which would be a profitable load for a smuggling trip. If short trips across state borders account for a significant volume of smuggling in some areas, consideration might be given to reducing this number.

#### *Uniform tax rate proposals*

It has been suggested that instead of a contraband bill, Congress should enact legislation designed to eliminate the state cigarette tax disparities which produce bootlegging. While a nationally uniform cigarette tax rate would eliminate bootlegging, there appears to be no likelihood that such legislation could be passed in the foreseeable future. The Advisory Commission on Intergovernmental Relations has termed an effort toward such legislation as "an exercise in political futility—tantamount to a do nothing policy".

The ACIR's observation stems from the fact that the enactment of a uniform rate would necessitate substantial cigarette tax rate raises in a majority of the states. The uniform rate bills now in Congress would impose a combined state-federal cigarette tax rate ranging up to 35 cents per pack. In effect, the uniform rate bills ask Congressmen to vote to increase the cigarette tax rates on their own citizens sharply. The experience of the energy tax proposals relating to federal gasoline taxes has shown how difficult it is to develop Congressional support for excise tax increases.

If Congress takes no action on a contraband bill this year, and a protracted debate over uniform rate legislation extends over a span of years, cigarette bootlegging will continue to grow and the existing problems will become magnified both in their intensity and in their geographical impact.

STATE OF CONNECTICUT,  
Hartford, Conn., December 12, 1977.

PAUL SUMMITT,  
Chief Counsel, U.S. Senate, Committee on the Judiciary, Subcommittee on Criminal Laws and Procedures, Washington, D.C.

DEAR SIR: This letter is in response to Senator McClellan's letter of November 25, 1977 requesting my recommendation about S-1487, a bill being proposed to eliminate racketeering in the sale and distribution of cigarettes.

The State of Connecticut strongly supports this important piece of legislation. The proliferation of cigarette smuggling, organized crime involvement and the interstate nature of smuggling activities create a demand for Federal law enforcement in this area. Federal involvement will enhance enforcement activities and contribute to a coordinated effort to deter this criminal enterprise.

Connecticut has been actively involved in combating cigarette smuggling since 1971. This department has documented several cigarette smuggling cases involving several thousands of cartons of untaxed cigarettes that show organized crime figures from Connecticut to be involved. In some cases, this involvement extended to New York City crime families. While Connecticut's enforcement efforts in this area have just about eliminated the independent smuggler, syndicated operations are still a problem.

I believe the penalty proposed in S-1487 is sufficient and is in line with Connecticut's penalty (imprisonment of not more than 5 years and/or a \$5,000.00 fine). Also the cut-off limit of 20,000 transported cigarettes is in line with Connecticut's misdemeanor/felony cut-off amount.

There will be no response to the Committee from Mr. Salafia and Mr. Breece of the Connecticut State Tax Department as this letter reflects their comments.

Sincerely,

GERALD J. HEFFERNAN,  
Tax Commissioner.

STATEMENT SUBMITTED BY HAROLD J. HESS, INSPECTOR, COMMANDING OFFICER, INTELLIGENCE DIVISION, POLICE DEPARTMENT, THE CITY OF NEW YORK, N.Y.

Since the mid 1960's the problem of the smuggling of contraband cigarettes has grown continually. Law enforcement agencies have attempted to combat the smuggler with little success and, until very recently, have uncovered practically nothing relative to the organization of cigarette smuggling operations. What can be said with certainty is that organized crime has taken advantage of this victimless crime to reap new profits to pour into its criminal empire.

New efforts have been mounted on both an enforcement and intelligence level and analysis of the information uncovered allows for at least some definitive statements. However, nothing written here can be accepted as total or final knowledge since the structure of smuggling operations, like the structure of organized crime itself is constantly changing.

It has become evident that there are two types of cigarette smugglers:

1. The independent with no direct ties to any large organization and who operates on an irregular basis supplying cigarettes on specific individual orders only;

2. The organized crime member or associate who has been established in business through the financial resources of organized crime and who is indebted to the organization because of this assistance.

The first of these two operations can continue indefinitely as long as the business remains limited. If an independent operation begins to expand and become a threat to the profit of the larger organized crime based operation it will either be eliminated as competition by assimilation into the larger organization or forced out of business entirely.

The organized crime involvement in cigarette smuggling is based on the long standing practice of participation in those activities (e.g. gambling; prostitution) which provide the maximum profit with the smallest possible investment. Further, this same principle involves the isolation of the actual organized crime member from day to day business, when possible, thereby minimizing the chances of apprehension. In addition organized crime has always participated in victimless crimes, such as cigarette smuggling, where the penalty for law breaking is usually a short prison term or a fine that amounts to little more than a license to operate.

It is obvious that in order to make significant inroads into the cigarette smuggling problem organized crime must be understood and confronted. The first step in this process must be the acceptance of the proper explanation of what organized crime is. It has been the practice of law enforcement agencies to refer to organized crime in an ethnic sense. Because of the publicity given to the infamous Joseph Valachi and the nation wide media coverage given the Senate hearings at which Valachi testified, organized crime has been categorized as Italian. This concept is not only unfair it is inaccurate. The proper definition of organized crime is one which refers to the grouping of persons for a criminal purpose without reference to any particular ethnic origin. This proper concept of organized crime is important in light of the subject of this report which is attempting to make the reader cognizant of the involvement of organized crime in the smuggling of untaxed cigarettes.

The ethnically oriented Mafia is still a factor in crime and is deeply involved in the smuggling of contraband cigarettes. However, to limit consideration of cigarette smuggling problems to this organization would be to overlook the deep involvement of other groups also well organized and just as ruthless in their pursuit of profit. The attack on organized crime must, therefore, be centered on individual groups of criminal violators as well as the traditional concepts of a strictly structured organized crime syndicate.

Historically, the problem of organized crime involvement in untaxed cigarettes is dated from the first operation of Anthony Granata and his original

backers, Ralph and Mario Gigante, Genovese family soldiers. From this beginning a large scale problem has grown that today encompasses organized crime as well as persons whose names were never known to law enforcement agencies before they became involved in contraband cigarettes.

Today cigarette smugglers must meet basic requirements to stay in business. Each smuggler must have a system of distribution and since the number of illegal cigarettes in a given area must eventually reach the saturation point the smuggler must be able to defend his territory against the encroachment of other suppliers.

By creating a system of distribution the smuggler becomes a factor in organized crime. He becomes the source of income for other persons who are dependent upon the successful delivery of his product for the maintenance of their illegal profit. As his business grows the smuggler will isolate himself from the day to day operations by hiring drivers to make the trips to the tobacco producing states and other drivers to make necessary deliveries to those outlets from which the public is supplied with their illegal cigarettes. A successful smuggler can then diversify his profits into other illegal enterprises or into legitimate business investments. As his profits grow the smuggler can become a legitimate power in organized crime. The expression "money talks" is never truer than when it is applied to criminal activities. The criminal who controls the purse strings may eventually control the organization itself.

It is when a cigarette smuggler feels the threat of profit loss that his participation in a victimless crime may become the basis for his graduation into hijacking, arson, assault and even homicide. While organized crime members have, as previously stated, usually been desirous of maintaining a low profile they will go to extremes to recoup or to prevent monetary losses. It is not unusual that innocent persons may be injured during these vendettas that the press finds so newsworthy and that a large segment of the public dismisses with the thought that they are only killing each other. Further, the investigation of those crimes of violence places the lives of law enforcement officers in serious jeopardy.

During the last decade the metropolitan areas of the northeastern seaboard lost literally millions of dollars in uncollected taxes through the smuggling of contraband cigarettes. At a meeting of nine states, held in Hartford, Connecticut in February 1974, it was decided to form some sort of association to combat the cigarette smugglers and to stop the resulting drain on state and city treasuries.

After careful consideration, and consultation with legal experts, the Eastern Seaboard Cigarette Tax and Enforcement Group was created. To be effective the Group had to be more than a debating society, it had to be an efficient and practical enforcement weapon. To this end the enforcement arm of the Group was placed under an Executive Director who was given full authority to formulate and execute field operations using investigators drawn from the Groups member agencies.

In April of 1974 the Group initiated the enforcement aspect of its operations. This cooperative inter-state effort was christened "Operation Butt" and has been continued since its inception on an irregularly patterned schedule. The results have so far yielded cigarette seizures amounting to a tax savings of one-quarter of a million dollars and a loss to the cigarette smuggler of more than one-half million dollars. As a side benefit to participants in the Group each of the agencies involved has gained access to intelligence information that it would not have been able to develop on its own and the picture of who the smuggler is and how best to stop him has become much clearer.

A second purpose of the Group, but one of equal importance to enforcement, is the education of the public as to the type of criminal enterprises they are indirectly helping to support through the purchase of untaxed cigarettes. The public must be made aware that the purchase of contraband cigarettes, which seems to be an immediate savings that relieves some of the constantly increasing inflationary pressure, is actually a long term loss in increased taxes that are inevitably levied by government to compensate for revenue not realized. The first steps in this program have been taken through selected release of information to members of the press that enable the Group to make its purpose and the reasons for its existence known.

The story of this Group is not one of total success. Even with the commitments of the participating states the Group still finds itself critically short of money and equipment. No enforcement and intelligence gathering organization can be expected to function at its optimum without the proper financial support

and the lack of that support could threaten the very existence of this Group. It is the objective of the Group to function on a continuous basis constantly updating information necessary for a good over all picture of the operations of the cigarette smugglers. In order to accomplish this the states have agreed to contribute both the necessary manpower and salaries but no one or combination of those states, has sufficient budgetary latitude to provide for equipment purchase or pay for the constant travel of the assigned investigators. Considering the return on the financial investment, in the form of increased state revenues, it is up to the federal government to come through with the necessary support to keep this proven worthwhile and productive program in existence.

Two things have become clear; the penalties for smugglers when they are apprehended are usually far too lenient and there is a need for some basic change in the cigarette tax structure. To be an effective deterrent to the smuggler, sentences must be increased to the point where they create some fear of apprehension. But, if cigarette smuggling is to be entirely eliminated then tax reform is a necessity. Perhaps the often proposed, and never acted upon, nationwide uniform tax with proportionate reimbursement to the states is the answer. Whatever the final solution will be, it is the current tax law that is keeping the smuggler in business and until it changes, his business will continue to grow and prosper while legitimate wholesalers are forced out of business.

The wholesale tobacco industry in New York could be destroyed by cigarette smuggling if the problem is not checked soon. Several dealers in the New York area have already closed their doors and others may follow suit. If this happens we face the prospect of an industry, not only infiltrated by organized crime, but entirely dominated by criminal elements.

In order that such situations, as described, be avoided it will be necessary for the Federal Government to enact legislation which provides for:

1. Violations for transport of more than 100 cartons of contraband cigarettes interstate;
2. Penalties of at least \$1,000 for first offenders with jail time for further violators;
3. Forfeiture of vehicles used for transport of contraband cigarettes.

In the long run it is the very existence of Federal law, not its severity, which will discourage smugglers who are reluctant to violate federal statutes.

#### A. PREPARED STATEMENT BY THE INTERSTATE REVENUE RESEARCH CENTER

In 1973 representatives from five Midwestern states (Illinois, Indiana, Ohio, Michigan and Minnesota) initiated a series of conferences for the purpose of discussing the increasing flow of contraband cigarettes into these state jurisdictions, and the significant revenue losses being experienced by the states as a result of this illegal activity. It was estimated that cigarette bootlegging was responsible for an accumulative cigarette tax revenue loss of approximately one hundred million dollars (\$100,000,000) a year to these states.

As a result of these conferences the state representatives formulated and submitted a grant application to the Law Enforcement Assistance Administration (LEAA) seeking funds for the purpose of establishing an information center responsible for developing and coordinating information pertaining to this criminal activity. Acting in behalf of the membership, the Indiana Criminal Justice Planning Agency forwarded the application to LEAA. In November 1974, LEAA awarded a discretionary grant in the amount of seven hundred and eighty-seven thousand, five hundred dollars (\$787,500) for the purpose of creating the center. In April 1975 the Interstate Revenue Research Center (IRRC) was established at Indianapolis, Indiana and since that date the Center has been engaged in a multi-state effort to identify and neutralize illegal cigarette activities within the Midwest.

After several months of operational experience the Center realized that it was challenging a problem which was much more expansive and sophisticated than initially envisioned. It became apparent that a more indepth review of the problem was essential before appropriate counteractions could be productively employed. Therefore, research efforts regarding the cigarette industry and related support systems were intensified for several months. The industry's systems were more specifically identified, evaluated and tested in relationship to the problem area.

Research and investigative efforts clearly indicated that the interstate smuggling of cigarettes and other related activities commenced over a decade ago. Profits from this illegal activity were extremely high. State laws in many jurisdictions were too weak in response to this growing problem. Additionally, it appeared that since the 1960's organized criminal elements enjoyed unrestricted opportunities to refine their operations; establish protected bases of operation; and perfect delivery systems which bear all the trademarks of legitimate businesses. Vending companies, wholesale distributors, discount stores, and other front activities were established in numerous locations to facilitate the mix of legal and illegal smuggled/hijacked cigarettes. Analytical studies suggest that statistics relating to per-capita cigarette consumption rates and other trend indicators for certain geographical areas have been fine-tuned for the purpose of concealing illegal interstate activities. By 1976, IRRC had a more comprehensive insight regarding the magnitude of the problem.

Overt and covert supply and distribution systems being utilized by major cigarette smugglers reflect the underworld's ability to exploit legitimate industries and bureaucratic systems for its personal gain. Established supply and distribution systems often reveal a degree of sophistication equal to the assorted, covert techniques utilized by an international narcotics ring. 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. These actions are viewed by the Center as being conspiratory acts between the supplier and smuggler for the explicit purpose of perpetrating an interstate crime. To date these deceptions have not been fully recognized or tested by any state or federal judicial system, except as pertains to the cigarette mail order business.

The Center has consistently collected information pertaining to residual criminal operations that are interwoven with illegal cigarette operations. It has become increasingly clear that parties involved in illegal cigarette activities are also engaged in other major criminal enterprises, i.e., interstate auto theft rings, hijacking and warehouse thefts, interstate fencing operations and counterfeiting. There is little doubt that organized crime has penetrated various segments of the cigarette industry at the wholesale and retail level and its sphere of influence is expanding.

The illegal cigarette trade, like any other dedicated commercial enterprise, cultivates and exploits all lucrative regional markets. Considerable flexibility and ingenuity are expressed by those individuals who direct high volume operations. These smugglers are knowledgeable of individual state statutes, regulating processes, and systems used to monitor or enforce cigarette tax laws. They possess a proven capability to utilize statutory weaknesses or omissions for their advantage. This will continue unless stronger and corrective legislation at the federal and state levels, blended with better enforcement efforts, materializes within the immediate future.

Significant progress in the legislative sector has been recorded by several of the Center's membership states during the past year. However, IRRC experience unquestionably indicates that unless appropriate federal legislation and a dedicated law enforcement effort are soon forthcoming, organized criminal operatives will continue their massive assault against the legitimate cigarette industry. And free enterprise systems within additional state jurisdictions will give way to the "Smoke Kings" of organized crime.

Therefore, this Center in behalf of its membership totally endorses S. 1487 as it presently stands before the Subcommittee on Criminal Laws and Procedures. Further, the Center recommends the earliest possible passage of this bill by the Senate.

STATEMENT BY JOSEPH KOLODNY, MANAGING DIRECTOR OF THE NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS

Illicit cigarette bootlegging is costing the 50 states and local tax authorities in excess of \$400,000,000 annually in tax revenue. In addition, legitimate business (the tobacco wholesalers and retailers) are sustaining losses in the millions of

dollars and are finding it impossible to compete with organized crime paying no taxes and not subject to normal business expense.

Recently, Time Magazine, in its excellent cover story "The Mafia—Big, Bad and Booming," concluded:

"Above all, there must be an end to American tolerance for any kind of organized crime. Romantic notions about the dons and winking acceptance of their goods and services create an atmosphere that helps the mob to flourish. Without a profound shift in public attitudes, even the most aggressive law enforcement drive against the Mafia and organized crime has scant chance of permanently cutting into their activities, let alone putting them out of business."

The recent report of the New York State Special Tax Force on Cigarette Bootlegging and the Cigarette Tax includes the following statement:

"Contraband cigarettes in the past have been retailed mainly through businesses which don't normally deal in tobacco products, such as beauty parlors, barber shops, and other such business places, as a convenience to their customers and an added source of revenue for themselves—and even, as another example, from the back of a station wagon at a construction site. In recent months, however, the State has discovered that these untaxed cigarettes are being increasingly sold in legitimate retail outlets. In other words, more and more business men and women, who are law-abiding in other respects, have become law-violators by evading the cigarette tax. Moreover, they are assisting in robbing the State of much-needed revenue at the same time that they are becoming accomplices of big-time racketeers and small-time hoodlums. Perhaps the most tragic, the legitimate retailers who have become tax-evaders by selling contraband are subjecting themselves to arrest and criminal prosecution with resultant disgrace to their families as well as themselves.

"Manufacturers' trucks have been hi-jacked, resulting in heavy losses to them and an impact on their insurance rates. These hi-jacks are professional in nature and are believed to be the efforts of organized crime. Organized crime does not care whether the cigarette packs are stamped or without tax indicia, as they have the outlets to dispose them.

"Because of the increase in hi-jacking and wholesale thefts, to maximize the illicit profits in the high-tax-rate States, motor carriers are turning down legitimate cigarette shipments, and insurance rates of licensed cigarette warehouses are skyrocketing.

"Investigations, surveillances, and informants have resulted in bringing to the attention of the States that the violators are becoming more sophisticated and move their operations frequently. Their sources of supply, routes of travel, places of reloading, storage warehouses, and sources of disposing of cigarettes are constantly changing, which makes for more difficult investigations and apprehensions."

Through these illegal profits on excess of \$100,000,000 annually, the underworld is able to expand its tentacles into other criminal activities such as narcotics, prostitution, and related gambling activities or even to infiltrate into legitimate business. Recently, a well dressed individual walked into the office of an established wholesaler and offered to purchase for cash a substantial quantity of unstamped cigarettes to be shipped through the Panama Canal to a destination in New York State. The sale was not consummated as the State of California would not license it, indicating underworld implications.

It is asserted that the major cigarette distributors in the New York City area are, in effect, the underworld which accounts for over half of all cigarettes dispersed with a resulting tax revenue loss of \$85,000,000 annually.

One may question whether this is a localized problem for New York City and the eastern seaboard. The answer is definitely, "No." What may have started as a problem for New York State has spread to the other northeastern states, the southern states particularly Florida, and in midwestern states. It will continue to spread if states continue to raise cigarette taxes to meet the need for added revenue and the tax differential continues between states such as North Carolina 2 cents, Virginia 2½ cents, Kentucky 3 cents and Indiana 6 cents.

It is estimated Missouri is losing \$1-\$6 million annually in cigarette tax revenue from bootlegging out of North Carolina and Kentucky, particularly the latter through southeastern Missouri which borders on Kentucky. Kansas was conducting an independent audit of a licensed wholesaler suspected of bottlegging. Thus, cigarette bootlegging is not alien to most of the 50 sovereign states.



Recently a former Kansas City cigarette distributor was named in a 42 count indictment of bootlegging cigarettes from North Carolina and Oklahoma into Missouri, Kansas, Nebraska and Texas without payment of state and local taxes. It is claimed Missouri and Jackson County are due \$1½ million in unpaid cigarette tax, penalties and interest. It goes without saying that all of us are affected by this delinquency.

Last month CBS on "60 Minutes" and NBC on the "Today Show" provided excellent factual reports depicting the extent of cigarette bootlegging.

Three possible solutions have been suggested. Firstly, state tax uniformity with the 50 states each exercising its rights based on their fiscal need in the levy and imposition of cigarette taxes. There is no likelihood for this suggestion to ever become operative. Legislative bills have been introduced both in Kansas and New York to reduce their cigarette tax. In Kansas the bills never got out of committee, and in New York where tax relief is sorely needed it was defeated, even though the tobacco distributors of New York offered to set up an escrow fund of \$18,000,000 to offset any revenue loss from the reduced tax.

Secondly, for the Federal Government to pre-empt state cigarette taxes and establish a Federal uniform tax rate with revenue sharing to the states and indirectly to local tax authorities. For Congress to take away from the states their prerogative to cigarette taxation is—at this juncture—wishful thinking.

Thirdly, and lastly, to make cigarette bootlegging in interstate commerce a federal offense. This solution we firmly support since the states do not have the power nor revenue to control its escalation.

In December, 1976, the United States Advisory Committee on Intergovernmental Relations (ACIR) held a hearing at Washington, D.C. Following this hearing the Advisory Committee concluded:

"... that large state cigarette tax differentials and the difficulty in controlling the interstate flow of contraband cigarettes have created an environment conducive to the large scale involvement of organized crime in cigarette bootlegging.

"In order to enhance the effectiveness of cooperative state and federal enforcement efforts, Congress should give early and favorable consideration to legislation prohibiting the transportation of contraband cigarettes in interstate commerce."

Congressman Patterson (California) and Senator Bellmon (Oklahoma) have introduced companion bills with the technical advice of the Bureau of Alcohol, Tobacco and Firearms making it a federal offense to transport in interstate commerce in excess of 20,000 cigarettes bearing no evidence of the payment of applicable state cigarette taxes in the state where found and which are in the possession of any person other than those specifically defined by law to have legal possession. Violation will be a felony calling for a fine not to exceed \$10,000 or imprisonment for not more than two years or both.

Senator Edward Kennedy, Chairman of the Senate Committee on Crime, has held a preliminary hearing to be followed by a full hearing following the reconvening of Congress next year. Additionally, Congressman Eilberg (Pennsylvania) has introduced a bill for which a hearing has been asked of Congressman John Conyers, Jr., Chairman, House Subcommittee on Crime.

BOB BULLOCK,  
Austin, Tex., October 11, 1977.

Hon. JOHN L. McCLELLAN,  
Chairman, and Members of the Subcommittee on Criminal Laws and Procedures,  
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR McCLELLAN AND MEMBERS OF THE SUBCOMMITTEE: We have been concerned about illegal cigarette smuggling in Texas since I've taken office on January 1, 1975. One of our continuing frustrations has been the lack of support from the Federal Government in dealing with this criminal situation.

It was therefore, very satisfying to know that the Senate Subcommittee on Criminal Laws and Procedures was holding hearings concerning this illegal trade in cigarettes.

Enclosed you will find testimony from me concerning problems Texas has, and our position on this matter. You will not that we not only have a potential organized crime problem, but the loss of revenues because of cigarette smuggling is staggering. At a time in our country's history, when people are up-in-arms about

rising taxes and the concern over tax reforms, it is intolerable that we allow so many dollars in tax revenue to be lost due to criminal activity.

It is therefore with great pleasure that I submit this testimony for the official hearing record of the Subcommittee. Thank you for the opportunity to do so.

Sincerely,

BOB BULLOCK,  
Comptroller of Public Accounts.

Enclosure.

STATEMENT OF BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS, STATE OF TEXAS

DEAR SENATOR McCLELLAN AND MEMBERS OF THE SUBCOMMITTEE: As the chief financial officer of the State of Texas, I am writing to you today to offer my full support for the passage of a Federal Contraband Cigarette law. The adoption of a bill such as S: 1487 would be a significant step towards abating the rapidly growing problem of cigarette smuggling throughout the country.

The involvement of organized crime in illicit cigarette operations has been well documented by various governmental reports and the news media. This organized form of willful, large-scale tax evasion has placed a heavy burden on state cigarette tax administrators and law enforcement agencies, and has placed the legitimate tobacco industry at a competitive disadvantage. In particular, the problem has become acute in those states with high cigarette tax rates.

As an illicit operation that relies heavily on interstate transportation for its success, cigarette bootlegging is a problem that warrants Federal Government attention. Federal contraband legislation would remedy the jurisdictional problems that state officials have experienced in tracking the flow of illicit cigarettes. Most studies indicate that the majority of bootlegging operations depend on the crossing of several state lines to minimize the likelihood of detection. The ease of moving a shipment of contraband cigarettes from low-tax, cigarette producing states in the East to Texas is obvious, and this problem is further aggravated by Texas' lack of jurisdiction along the route. At present, our state's cigarette tax enforcement program, as well as that of other active states, relies too heavily on the informal, voluntary cooperation of other state and local law enforcement agencies which understandably have their own priorities.

Finally, federal contraband legislation would aid our state's effort in two other areas in Texas where the Federal Government has primary jurisdiction: the Texas-Mexico border and the many military installations in Texas.

#### THE SIZE OF THE TEXAS PROBLEM

Texas, the third largest state, has an estimated population of over 12.3 million. Moreover, the state has a border of over 2,842 miles including the Texas/Mexico border, the interstate border, and Coast line of the Gulf of Mexico. There are over 90 points of entry into Texas by motor vehicles consisting of international bridges, interstate highways, U.S. and state highways, and farm-to-market roads. In State Fiscal Year 1977, ending August 31, 1977, Texas collected over \$278 million in cigarette taxes at the rate of 18.5 cents per pack of cigarettes. Last year, Texas ranked third in gross cigarette tax collections in the United States. The tax rate is the fourth highest in the nation although the State allows neither a sales tax or a local tax on cigarettes. These characteristics (large population, extensive border, high tax rate) combine to make Texas a prime candidate for cigarette bootlegging.

#### ESTIMATED TAX LOSS

In a recent report, the U.S. Advisory Commission on Intergovernmental Relations estimated that Texas loses \$43 million annually to interstate cigarette bootlegging, the second largest dollar loss in the nation. The U.S. Department of Treasury, Bureau of Alcohol, Tobacco and Firearms estimated a \$14 million revenue loss in Texas from cigarette smuggling across the Mexican border. The combined estimate of tax loss is an alarming \$57 million. Of course, these two figures are only estimates, and it would be impossible to get an exact dollar loss attributable to cigarette bootlegging. However, the two figures are a fairly accurate indication of the potential for smuggling, and we could find our state in the same situation that confronts New York and several northeastern states. Even with large budgets to specifically attack this problem, these states are still in need of federal assistance. Texas could find itself in this predicament in the next few years.

In addition, reports from other states show that cigarette smuggling operations have a multiplier effect: Money gained from cigarette smuggling is used to finance other criminal activities thereby further entrenching the organized criminal element in the state.

#### TEXAS' CIGARETTE TAX ENFORCEMENT PROGRAM

My office has recently organized an aggressive cigarette tax enforcement program which has a three fold purpose (1) to train Comptroller's staff in detecting cigarette smuggling operations; (2) to familiarize state and local enforcement officers with the problem, and (3) to raise public awareness to a problem that is all too often greeted with apathy. I feel confident that our program will significantly decrease small smuggling operations and will make a small dent in organized criminal smuggling. However, the missing link in our operation is Federal assistance.

#### SUMMARY

I strongly urge you to pass a vigorous cigarette contraband bill. This would be a positive step toward reducing the cigarette smuggling problem. I realize that Federal contraband legislation will not be a cure-all, nor should it be a substitute for the effort that the states are already making. Instead, it can serve as a complement to state cigarette tax enforcement programs, and it will provide the basis for vigorous enforcement. More importantly, it will formalize the relationship between the different law enforcement agencies and provide the criminal justice interface necessary for effectively combatting cigarette bootlegging.

#### STATEMENT BY J. ROBERT MURPHY, DEPUTY DIRECTOR, NEW JERSEY DIVISION OF TAXATION

My name is J. Robert Murphy. I am the Deputy Director of the New Jersey Division of Taxation and immediate past president of the National Tobacco Tax Association, whose membership consists of state tax administrators.

On behalf of the State of New Jersey and NTTA, I strongly urge expeditious Senate action to curtail and combat cigarette smuggling by enacting S1487 making it a federal offense to transport contraband cigarettes in interstate commerce. This legislation was introduced and co-sponsored by Senators Bellmon (Oklahoma) and Anderson (Minnesota).

The cigarette smuggling activity started in 1965 and has steadily germinated into a massive national problem. It has become more flagrant in recent years with the infiltration of organized crime in this illegal activity. Our best guess estimate is that organized crime, by gradually gaining control of the operation, has profited the past year by at least \$125 million. Further, the estimated revenue loss to the states for the same period exceeded \$400 million.

To indicate the seriousness of the cigarette smuggling problem, at the recent meetings of NTTA this topic was top priority for discussion.

My overall concern is with the enforcement relative to curtailing illegal trafficking, and I strongly believe that the only way that this can be accomplished is by federal legislation such as Senate Bill No. 1487.

When the cigarette problem began to engender in the late 1960's, the states floundered for many years in coping with the situation. However, in the early 1970's this illegal operation expanded and organized crime became interested and rapidly infiltrated due to the vast profit potential. As organized crime becomes further entrenched, it will not only control cigarette smuggling but also infiltrate, if it has not already, legitimate businesses.

In view of the foregoing, the states have manifested effective enforcement programs, individually and collectively, by establishing specialized enforcement groups that have the power of arrest; enacting state legislation to strengthen the criminal statutes; develop multistate enforcement groups for dissemination of intelligence information and cooperative surveillance operations; and have also solicited the news media to effect orientation programs to alert the public sector about the illegal cigarette activities and the involvement of criminal elements. In my judgment, I believe that the states have performed admirably and today possess enforcement groups that have the expertise and dedication to do an effective job.

However, with the infiltration of the racketeer element and the manpower and resources available to it, coupled with lack of jurisdiction for state enforcement personnel crossing state lines, a major problem has arisen for the states to be effective to curtail cigarette smuggling. Further, because of the economic climate that prevails which has resulted in the lack of additional personnel and funds to operate effectively, the enforcement group has been limited in scope of investigations and surveillances and, thus, has been confined to a great degree to its borders.

I believe that some history relative to the expansion of cigarette smuggling may be in order and, therefore, I would like to retrospect somewhat in this area. Initially, the smugglers were those who held full-time jobs in industrial or office complexes, etc., who would journey to the low tax rate states over the weekend. They would make one trip and return with small cargos of cigarettes, anywhere from 500 to 1,000 cartons, and ultimately sell them to their co-workers at a profit of approximately 50 cents a carton. The expenses incurred by the smugglers would be minimal. Needless to say, a handsome profit for approximately 24 hours was realized. It should be noted that to embark on a career of cigarette smuggling there is little or no capital investment.

Gradually, as state cigarette taxes increased the smuggling tempo rapidly expanded, and the "fast buck" to be made quickly brought about the intrusion of the criminal element.

There is ample documentation by many states that cigarette smuggling is organized. This can be substantiated by the United States Department of Justice. Further, those apprehended over the past several years, male and female, have been found to have criminal records, denoting involvement in the entire criminal spectrum; i.e., murder, narcotics, armed robbery, gambling, forgery, etc.

Presently, the profit on the sale of a carton of contraband cigarettes ranges from \$1 to \$1.50, and it is anticipated that the gross receipts to be realized by the organized cigarette smugglers is gradually estimated to exceed \$150 million. We must be cognizant of the fact that the profit from cigarette smuggling is channeled to the hierarchy of organized crime, and because of the "easy profit" the funds may be used to promote or expand other types of illegal activities.

An area that is not usually taken into consideration is the income tax aspects, both federal and state. It is unheard of that any cigarette smuggler would report on an income tax return illegal income. This, naturally, results in additional revenue losses to the federal and state governments.

There is ample evidence available to substantiate that many legitimate cigarette entrepreneurs are being forced out of business because they cannot compete with the cigarette smuggler and, thus, results in unemployment for many workers. There has been testimony that in New York City alone, approximately 38 percent of the legitimate cigarette wholesalers have been forced out of business because of the intrusion of contraband cigarettes. Also, and of paramount importance, because of the involvement of the criminal element in the illegal cigarette trafficking there have been numerous hi-jackings and homicides. Therefore, cigarette smuggling can no longer be considered a victimless crime and must be taken seriously. We in the New Jersey Division of Taxation have fostered programs with federal agencies. Recently, information supplied to the Internal Revenue Service, Intelligence Division, assisted in the conviction of a well-known criminal figure who resided in New Jersey and operated in New York. This individual has been deeply involved in cigarette smuggling for many years. As a result of the conviction he is presently incarcerated in federal prison. Additionally, in October, 1976, special agents from our Division worked in concert with the FBI, state police, and county prosecutors offices and broke up a month-long cigarette smuggling ring, confiscating 26,000 cartons and arresting 10 people. These raids were made simultaneously at 7 different locations, and was one of the largest seizures of its kind.

Recently, New Jersey enacted state laws which will permit casino gambling in Atlantic City. With the enactment of this legislation an investigation revealed that a well-known member of organized crime in Pennsylvania immediately took steps to establish a cigarette operation in the area.

As indicated heretofore, it is extremely costly for the states to underwrite undercover investigations out of state when they will encounter serious enforcement problems being powerless to make arrests outside of the borders of their own state. Unless "appropriate tools" are made available in the form of federal cooperation through manpower and legislation, organized crime will expand to such a degree that cigarette smuggling will never be contained. As organized

crime expands in this illegal operation, it will have additional manpower and resources available to it and be in a position to become even more sophisticated and professional. They will not only control the cigarette smuggling and hi-jacking operations, but will infiltrate the legitimate tobacco industry which is one of the largest in the United States.

Cigarette smuggling encourages hi-jacking. Over the past year hi-jackings have been on the increase and have resulted in kidnapping, assaults, loss of cigarettes and vehicles, etc. As a result, many manufacturers, due to the unavailability of drivers due to fear and prohibitive insurance rates, have contracted with outside firms to make their shipments. Many of the large trucking firms are not receptive to accepting this business and, therefore, the manufacturers are dealing with smaller trucking firms who accept the business but are not in a position to carry insurance because of the prohibitive rates.

The impact of cigarette smuggling has caused hearings by the Advisory Commission on Intergovernmental Relations which resulted in the recommendation that federal legislation be enacted. Further, the Law Enforcement Assistance Administration has in its recent report expanded on cigarette smuggling and found fit to make available funds in some areas to combat the problem. In my judgment, both of the foregoing reports were exemplary accomplishments.

In the report of the Advisory Commission on Intergovernmental Relations issued in May, 1977, Edward Lorch, Detective, Intelligence Division, New York Police Department, elaborated on the violent crimes that were committed due to cigarette smuggling.

It is believed that the only remedy to curtailing cigarette smuggling is federal contraband legislation as set forth in the Senate bill in question. Time is of the essence. As the years pass, cigarette smuggling becomes more cancerous and will be more difficult to eradicate.

In closing, I will state emphatically that if the legislation in question is enacted you may rest assured that the states will continue to be vigilant and will put their resources in cooperation with the federal enforcement agencies.

As part of this report, I would like to offer a "Statement of Facts" prepared by me which, hopefully, will be of assistance to you. Further, I will be willing to avail myself to attend and testify at any future hearings that you may conduct on this proposed legislation.

At the recent meeting of NTTA, I articulated to the membership that statements should be forwarded to your committee relative to this proposed legislation, and it is my understanding that many have furnished same, incorporating articles issued by the news media pertaining to cigarette smuggling. In view of this, it is not my intention to burden you with additional documents for your review.

I wish to express my sincere appreciation to this subcommittee for permitting me to submit this statement on behalf of Senate Bill No. 1487, and hopefully the subcommittee will report the bill to the Judiciary Committee and ultimately will be enacted into law.

Thank you.

STATEMENT BY WILLIAM A. O'FLAHERTY, PRESIDENT, TOBACCO TAX COUNCIL, INC.

The Senate Subcommittee on Criminal Laws and Procedures is to be lauded for its attempt to focus on the problem of cigaret bootlegging. As President of the Tobacco Tax Council, an organization which represents all segments of the tobacco industry on matters of tobacco tax legislation, I am pleased to present our viewpoint concerning one proposed solution to the bootlegging problem: federal contraband legislation.

As you have already learned cigaret bootlegging is a major tax administration problem in many northeastern and Atlantic seaboard states. In these states, steadily rising state cigaret tax rates have created an opportunity for the bootlegging of cigarets from low-tax states. This opportunity was first exploited by small-time criminals who operated out of the trunks of their cars and from small trucks. However, as the differential in state cigaret tax rates increased, organized crime has recognized the tremendous profit potential in cigaret bootlegging and has virtually taken over the illicit distribution of cigarets in the high tax states. As a result, organized crime has taken a deep and painful bite into business in virtually every state where the cigaret tax structure differs substantially from that of an adjacent or nearby state. These states are losing badly needed tax dollars to the cigaret bootleggers and the legitimate

tobacco industry is being forced out of business with a loss of jobs and income for many honest citizens.

Cigaret bootlegging is a tax administration problem. The basic cause of cigaret smuggling is the disparity in state tax rates created by the legislatures in the high tax states. Therefore, the first step toward a solution to the problem of cigaret bootlegging is for the high tax states to reduce their cigaret tax rates to more reasonable levels. The removal of the incentive which attracted organized crime will go a long way in correcting the current problem. Without this first step, contraband legislation and increased law enforcement activities have no chance of succeeding in the elimination of cigaret bootlegging. The futility of a single-prong approach such as contraband legislation has been underscored by previous testimony before this Subcommittee. Representatives from the Advisory Commission on Intergovernmental Relations have stated that a federal contraband bill will solve only 30 percent of the current bootlegging problem.

Therefore, the Tobacco Tax Council believes that a four-pronged attack on organized bootlegging must be mounted. First, and in our judgment most important, high tax states with bootlegging problems must reduce their state tax rates. Without tax reductions the opportunity for cigaret bootlegging will remain and it will be exploited by organized crime as well as the casual smuggler.

Second, stronger licensing laws should be enacted by all states. The purpose of stronger licensing provisions should be to provide a means to prevent smuggled cigarets from entering the normal distribution channel without being detected. Also, stronger licensing requirements would help prevent criminal elements from obtaining licenses and therefore provide protection for the legitimate businessmen in the industry.

Third, the effectiveness and level of intensity of state law enforcement measures against cigaret bootlegging should be increased. State statutes should be broadened to adequately cover bootlegging activity and penalty provisions should be stiffened. These changes would hopefully improve cigaret tax compliance and judicial enforcement of the laws.

Finally, as a last step in our program to control cigaret bootlegging, the Tobacco Tax Council supports in theory the contraband legislation proposed by S. 1487. However, I hasten to emphasize that our support is predicated on the implementation of tax reductions in high tax states and increased enforcement of existing state laws. Unfortunately, the proposed contraband legislation has been approached as the cure for the ills of bootlegging. Those familiar with the tobacco industry know it is impossible for contraband legislation to work in the absence of state tax reductions, increased licensing requirements, and more effective law enforcement.

CITY OF NEW YORK DEPARTMENT OF FINANCE,  
New York, N.Y. December 28, 1977.

Re Senate 1487.

HON. PAUL C. SUMMITT,  
Chief Counsel, Subcommittee on Criminal Laws and Procedures, Committee on  
the Judiciary, U.S. Senate, Washington, D.C.

DEAR MR. SUMMITT: The late Senator McClellan's letter of November 25, 1977, addressed to Mr. B. H. Starkey, Chief of this Department's Special Investigation Bureau, has been forwarded to this office for response.

As you are no doubt aware, the City of New York—which levies an 8 cents per pack cigarette tax—loses a substantial amount of revenue each year as a result of cigaret bootlegging. It is estimated that the current loss of cigarette tax revenues is more than \$15 million annually; local sales tax revenue losses resulting from this illicit trade are estimated to be more than \$7.5 million annually. Needless to say, in view of its present financial plight, the City can ill-afford this continuing drain on its treasury. Unfortunately, the very financial constraints under which the City is now forced to operate prevent it from mounting the kind of enforcement effort needed to deal effectively with the problem of interstate cigarette smuggling.

Even if additional funds were available, the interstate nature of the movement of contraband cigarettes and the involvement of organized crime in that movement make it extremely difficult for any single state or locality to adequately cope with the problem. (With respect to the question of organized crime involvement, we understand that the New York City Police Department will be submitting to the Subcommittee a statement detailing the nature and extent of such



involvement. We therefore believe it is essential that the Federal Government assume a role in this vital area of law enforcement. Senate 1487 represents, in our view, a positive step in this direction, and we strongly favor its passage.

I would, however, like to make one observation concerning the proposed penalties contained in the bill. In order to provide a more effective deterrent, we would recommend that there be a minimum fine of \$1,000 for violations of its terms and that provision be made for the forfeiture of vehicles used in the transportation of contraband cigarettes.

Very truly yours,

MORRIS B. RAUCHER,  
*Director.*

STATEMENT IN SUPPORT OF S. 1487 BY ARTHUR C. ROEMER,  
COMMISSIONER OF REVENUE, STATE OF MINNESOTA

In 1960, the maximum differential in cigarette taxes between the states was eight cents; by 1965 the largest differential was eleven cents but by 1977 it was almost twenty cents a package in several states. The differentials resulted from the increased needs of the states for additional revenue, which results in increases not only in cigarette taxes but liquor, sales, income, severance and other sources of state and local revenue. While the non-tobacco producing states have been increasing tax rates generally, the tobacco producing states such as Virginia, North Carolina and Kentucky have increased other taxes but have not increased the cigarette tax significantly.

The disparity of tax rates coupled with the small size of cigarettes together with the completion of the freeway system, which made transportation of cigarettes easier, has resulted in a tremendous increase in cigarette bootlegging. Because of its interstate nature, the individual states lack criminal or civil jurisdiction during much, if not most, of the transit. In addition, the protections from search and seizure, together with changes in the rules of criminal procedure this past decade, relating to admissibility of evidence, has made it more difficult to apprehend bootleggers. The interstate smuggling of cigarettes is a serious problem in fourteen states and a moderate problem in at least eight. Documentation on this is contained in the ACIR Report, which was issued in May of 1977.

It is no small wonder that the criminal element is becoming interested in cigarette bootlegging since the tax differential on a semi-load of cigarettes may exceed \$100,000. The individual states simply do not have the resources to cope with the problem. In our state, we have substantially increased the size of our staff in the past few years. With the help of a grant from LEAA, the Interstate Revenue Research Commission was formed. This is a group of states largely in the middle west (Minnesota, Illinois, Michigan, Ohio, Indiana and now Florida) which have joined together to pool some of our resources to monitor, curtail, reduce or eliminate the bootlegging of cigarettes. In addition to the central staff of the IRRC, a liaison member was stationed in our state.

Our regular investigatory staff consists of six investigators whose principal obligations involve auditing of distributors but whose duties also include surveillance of possible bootlegging activities. In 1976 we increased this staff by two additional investigators whose sole responsibility was investigation of bootlegging outlets and transportation. In 1977, with the help of a grant from the Governors Crime Commission, we have been authorized two additional investigators, who are now being hired. This has resulted in a substantial increase in prosecutions and confiscations but without any noticeable change in the amounts smuggled into the state.

In another area, we have significantly increased our penalties for illegal bootlegging. In 1975, our Legislature, at the request of the Department of Revenue, authorized confiscation of any vehicles utilized to transport 25 or more cartons of unstamped or improperly stamped cigarettes. In 1977, again at the request of the Department of Revenue, the Legislature changed the penalty for illegal transportation of 100 cartons of cigarettes or more from a gross misdemeanor to a felony. Despite these efforts, it appears that the bootlegging of cigarettes into our state continues. It is our belief that syndicated organized crime, which appears to be operating on the east coast, is not operating in our state. The usual type of organized crime in our state is a loosely formed organization of plant employees, bartenders, or small-time crooks who arrange for importation of cigarettes from North Carolina and Kentucky for distribution in our state at a substantial profit but still somewhat under the local price of tax paid cigarettes.

The method of distribution is either through known patrons, customers, associates or friends or to fellow plant employees. In many instances we find that the same individuals, who become involved in cigarettes, may also transport other illegal materials such as drugs, fireworks or alcohol.

According to the ACIR Report, our cigarette revenue losses in Minnesota from the bootlegging of cigarettes amount to over 12 million dollars a year. This constitutes almost fifteen percent of our total cigarette sales. Nationwide, they have indicated that the loss exceeds 391 million dollars.

However, in addition to the losses in cigarette taxes, both our state and the Internal Revenue Service are experiencing substantial losses in income taxes, which would be paid if these cigarettes were handled by legitimate distributors. It is obvious that the cigarette bootleggers are unlikely to report on either their federal or state return (if they file one) the profits from illegal bootlegging activities.

We have estimated our losses in state income tax, that would be paid by legitimate distributors had these cigarettes been handled through legitimate operations, to exceed \$372,000 a year. A conservative estimate of the amount of federal income tax that would be paid by distributors by reason of operations in our state would exceed \$63,000 a year. Since our state has less than two percent of the population and wealth of the whole United States, it is obvious that the total losses in income taxes would probably exceed 50 million dollars a year. Substantial additional taxable income would be generated and increased income tax would be payable by the retailers or vending outlets if the volume now handled by bootleggers were handled by legitimate outlets. Additional losses would also be incurred by the states in sales tax revenues and other small revenue sources.

Prior to the passage of the Jenkins Act, 15 USC 375-378, and the United States Mail Fraud Act, 18 USC 1341, the United States mail was used extensively in bootlegging operations. These two Acts of Congress have been successful in curtailing almost all mail order cigarette bootlegging activities. Only one state still considers mail order purchases of cigarettes as one of its major problems.

The lack of access to records on sales of cigarettes has been one of the most difficult problems facing our investigators. Many, if not most, of the sources of bootlegged cigarettes are known to our agents and the investigators from the IRRC. However, it is now impossible to gain access to their records. In addition, there is no requirement that they maintain accurate records on their sales or that the person they are selling to be properly identified. It is a well-known fact that our investigators meet with community hostility, which may include surveillance of our investigators, in some of the North Carolina cities in which the outlets are located.

The record keeping and reporting requirements contained in S-1487 will be a very important factor in curtailing bootlegging activities. For the first time, a record will be available of the purchasers of quantities of cigarettes in excess of 100 cartons.

This should not create any problems for the industry since it would not apply to anyone other than cigarette distributors, who would normally be expected to keep such records for income tax purposes.

It is my feeling that Federal legislation outlawing bootlegging would be very effective in curtailing or eliminating illegal interstate cigarette traffic. The small-time criminal does not seem nearly as concerned about violating state laws as he is about violating federal law. It would also permit investigators, who are now working closely with investigators from the Alcohol, Tobacco and Firearms Section, with respect to liquor violations, to coordinate their efforts toward the apprehension of cigarette bootleggers. Since these same criminals are often involved in other illegal activities, it would also be of assistance to other federal agencies with respect to their enforcement activities.

I strongly support the provisions contained in S-1487 and urge its passage by the Senate as soon as possible.

NATIONAL GOVERNORS' ASSOCIATION,  
Washington, D.C., October 21, 1977.

HON. EDWARD M. KENNEDY,  
Russell Senate Office Building,  
Washington, D.C.

DEAR SENATOR KENNEDY: State and local governments are losing an estimated \$400 million dollars annually in uncollected tax revenues because of cigarette smuggling by organized crime. Revenues that should go to support essential public services are being diverted to the support of criminal activities.

**CONTINUED**

**2 OF 3**

Cigarette smuggling is responsible for an increasing volume of criminal violations, including the highjacking of trucks and cargoes of legitimate enterprises. Because of its interstate nature, the individual states are rendered almost helpless in fighting this cigarette bootlegging.

In a policy statement adopted at its meeting in September, the National Governors' Association called for federal legislation to make interstate smuggling of cigarettes to avoid state and local taxes a federal crime. Enactment of legislation to require federal intervention to bolster the efforts of the individual states to halt cigarette bootlegging is vital. Legislation to make such bootlegging a federal crime is now pending before the House and Senate Judiciary Committees. On behalf of the NGA I urge your support for hearings and action by the committees in the next session of the Congress.

A copy of the NGA policy statement is enclosed.

Sincerely,

Gov. MILTON J. SHAPP,  
Chairman, Committee on Executive  
Management and Fiscal Affairs.

Enclosure.

NATIONAL GOVERNORS' ASSOCIATION POLICY POSITION B.-10, INTERSTATE  
SMUGGLING OF CIGARETTES

The Advisory Commission on Intergovernmental Relations has estimated that cigarette smuggling between low and high tax jurisdictions now costs states nearly \$400 million annually in uncollected cigarette tax revenues. In spite of extensive individual and collective efforts to curtail cigarette bootlegging, states have been unable to reduce its incidence. Indeed, revenue losses from cigarette bootlegging have grown rapidly in recent years and the practice is now a significant source of income for organized crime.

The Governors believe that the interstate nature of cigarette bootlegging and the growing involvement of organized crime in the activity underscore the need for federal intervention. The National Governors' Association supports the enactment of federal legislation which would make the interstate smuggling of cigarettes to avoid state and local taxation a federal crime. The Governors call upon the appropriate federal agencies, particularly the U.S. Department of the Treasury and the U.S. Department of Justice, to join NGA, the National Association of Tax Administrators, and the Advisory Commission on Intergovernmental Relations in supporting such legislation.

Adopted September 1977.

STATE OF NEVADA,  
DEPARTMENT OF TAXATION,  
Carson City, Nev., December 1, 1977.

Re S. 1487.

Hon. JOHN L. MCCLELLAN,  
U.S. Senate, Committee on the Judiciary Subcommittee on Criminal Laws and  
Procedures, Washington, D.C.

DEAR SENATOR MCCLELLAN: This letter is in response to your invitation to comment upon S. 1487 now being considered by the Subcommittee on Criminal Laws and Procedures.

When those of us who are involved in administering and collecting taxes, at the state level, first considered Federal legislation to resolve the cigarette bootlegging problem, I was philosophically opposed to the idea. However, because of continued frustration at the state level to resolve this problem I am now completely in favor of Federal legislation designed to curb and hopefully eliminate bootlegging problems. I believe that S. 1487 is the best proposal that I have had an opportunity to review to accomplish this goal. A concerted Federal law enforcement effort will be necessary to bring to a halt the mass bootlegging of cigarettes which, for the most part, is confined to the Eastern portion of the United States. The penalty imposed for illegal bootlegging must be stringent enough to constitute a deterrent. I believe that the penalty provision contained in S. 1487 meets that minimum requirement.

Information presented to me by responsible individuals more closely related to this problem convince me that organized crime plays a key role in the contraband question. The reports submitted to the Subcommittee regarding the dollar volume and financial gain reaped by organized crime, to my knowledge, are

accurate and I would refer to them regarding the financial contribution cigarette smuggling makes to organized crime. There is no evidence that organized crime is involved with cigarette smuggling in Nevada.

I indicated above that this problem primarily related to the Eastern States. This is because of the wide variance in state cigarette tax rates. Fortunately, the Western states have a more uniform tax rate on cigarettes and it is not profitable to illegally transport cigarettes from one taxing jurisdiction to another. That is not to say, however, such problem may not occur in the Western states and it could very easily happen should one state dramatically increase its cigarette tax rate.

I hope that my comments will be of assistance to the Subcommittee during its deliberations and I urge favorable action on S. 1487.

Very truly yours,

JOHN J. SHEEHAN,  
Executive Director.

STATE OF ILLINOIS DEPARTMENT OF REVENUE,  
Springfield, Ill., December 2, 1977.

Mr. PAUL C. SUMMITT,  
Chief Counsel, Subcommittee on Criminal Laws and Procedures, U.S. Senate  
Committee on the Judiciary, Washington, D.C.

DEAR MR. SUMMITT: The late Senator John L. McClellan requested on Nov. 25, 1977, that we indicate our views on S. 1487, a bill by Senator Henry Bellmon to deal with cigarette smuggling.

I am forwarding a copy of a letter we sent to Senator Edward M. Kennedy on the subject in the event that it may be helpful to Senator McClellan's successor on the subcommittee.

We deeply appreciated Senator McClellan's interest in our views about S. 1487 and would assure the subcommittee of our continued cooperation in its work on the federal contraband legislation.

Sincerely,

ROBERT M. WHITLER,  
Director of Revenue.

Enclosure.

STATE OF ILLINOIS, DEPARTMENT OF REVENUE,  
Springfield, Ill., October 4, 1977.

Hon. EDWARD M. KENNEDY,  
U.S. Capitol,  
Washington, D.C.

DEAR SENATOR KENNEDY: We were extremely pleased to learn that you will open hearings Oct. 10, 1977, on a bill (S. 1487) by Senator Henry Bellmon of Oklahoma that would help the states combat cigarette smuggling.

Cigarette smuggling is one of the most vexing problems faced by Illinois and states like her. Illinois relies strongly on cigarette tax revenues to help pay for the services provided to its citizens. But those revenues are vulnerable to anyone aware that our ability to protect them ends at our borders.

We strongly support Senator Bellmon's proposal. It is similar to legislation introduced in the U.S. House of Representatives by Congressman Tom Railsback of Illinois. He and several other members of our state's Congressional delegation have indicated their concern about the problem.

To states like Illinois, the importance of these bills is in the assistance they would provide in helping control the flow of contraband cigarettes. Illegal trafficking in untaxed cigarettes, which these bills would help to prevent, is extremely costly. There is:

1. The loss to state and local governments of up to \$400 million in tax revenue annually, according to a report on bootlegging by the Advisory Commission on Intergovernmental Relations issued in May.

2. The loss of services those revenues could have provided.

3. An increase in the tax burden on honest taxpayers, who are forced to make up for tax evasion.

4. Losses to legitimate business enterprises, which find it more difficult to compete with those not playing by the rules.

5. Proliferation of organized crime, which is able to use bootlegging profits to support loan sharking, gambling, prostitution, and similar types of illegal activities.

In "*Cigarette Bootlegging: A State AND Federal Responsibility*," issued in May, the Advisory Commission on Intergovernmental Relations reported and recommended:

"Cigarette smuggling is an interstate problem—organized crime and others take advantage of the limited jurisdiction of the states—and an effective solution requires federal legislation making interstate transportation of illegal cigarettes a federal offense."

Based on first-hand experience, we agree with both the analysis and the recommendation. The following are points gleaned from our own analysis and investigations.

#### INDUCEMENTS TO CIGARETTE SMUGGLING

The key inducements to cigarette smuggling are (1) the difference in tax rates between the states, and (2) the proximity of major population centers in high-tax states to wholesale and retail outlets in low-tax states.

Illinois taxes cigarettes at a rate of 12 cents per package of 20 cigarettes. Three of the five neighboring states currently tax at a lower rate: Indiana at 10.5 cents per package, Kentucky at 3 cents, and Missouri at 9 cents. The tax rates of the two other adjoining states are: Iowa, 13 cents, and Wisconsin, 16 cents.

The latest statistics (for calendar 1976 at which time Indiana's tax rate was 6 cents per package) on average per capita consumption of cigarettes in these states provide some indications of the problems caused by cigarette smuggling.

State	Population (1970 census)	Cigarette tax rate	1976 average per capita consumption
Illinois.....	11,113,976	12	3,810
Indiana.....	5,193,669	6	4,886
Iowa.....	2,825,041	13	3,607
Kentucky.....	3,219,311	3	6,617
Missouri.....	4,677,399	9	3,981
Wisconsin.....	4,417,933	16	3,384
Average consumption.....			4,380

The statistics were drawn from a report in May, 1977 by the Federation of Tax Administrators. The wide difference in consumption between Illinois and her neighboring states is most likely caused by one or both of the following factors:

1. The rate of consumption is related to the rate of tax. If the amount of tax is a key factor in the consumer's decision to buy cigarettes, he is less likely to buy cigarettes in a state in which a higher tax is imposed.

In Illinois, this factor is only pertinent when the buyer's choices are to smoke or not to smoke. Under the Illinois Cigarette Use Tax Act, a person who uses cigarettes in the state must pay the Illinois tax, regardless of whether a tax was paid to another state. Illinois law allows no credit for any cigarette taxes paid to another state.

This would mean, for example, that the total per-package tax on cigarettes bought in Indiana for use in Illinois would be 22.5 cents (Indiana's tax of 10.5 cents and Illinois' tax of 12 cents per package). To use Indiana cigarettes in Illinois without paying the Illinois tax is a violation of the law and would be considered smuggling.

2. The rate of consumption is related to cigarette bootlegging from low-tax states into high-tax states. Where there are significant differences in tax rates of neighboring states, profit or savings, though illegal, could be an incentive for both casual and organized cigarette smuggling.

We believe that bootlegging is the predominant factor in the difference between cigarette consumption in Illinois and the neighboring states with lower tax rates. Our belief is based largely on the fact that Chicago, the state's largest population center, is a major national tourism and convention center. As the Federation of Tax Administrators noted in an explanation of the May statistics:

... "States that have a large influx of tourists consistently have a per capita consumption well above the average because the actual number of people in the state is higher than Census statistics indicate."

Illinois, even with Chicago, its Lincoln heritage, and other attractions, has been the exception to this rule. The average per capita consumption in Illinois

in 1976 was nearly 15 per cent less than the average for her neighboring states, which do not have comparable tourism or convention trade.

There was an additional incentive to smuggling in Chicago since the city imposes its own 5 cent cigarette tax on each package sold. This brings to 17 cents per package the total tax on cigarettes sold for use in Chicago. In Indiana, only minutes away, the cigarette tax was 11 cents less, or a tax difference of \$1.10 per carton.

These factors most likely accounted for the significant differences in consumption among Illinois, Indiana, and Kentucky. We have no other reasonable explanation for the fact that average consumption in Indiana was 30 percent higher than in Illinois or for the fact that the average in Kentucky was 75 percent higher.

#### REVENUE LOSSES IN ILLINOIS

Illinois' cigarette revenue losses are difficult to compute because we are unable to estimate the extent to which smuggling occurs. There is, however, a number of statistical indicators, which would place losses at between \$10 million and \$26 million annually.

For fiscal year 1967, sales data gathered by the Tobacco Tax Institute disclosed that per capita consumption for Illinois residents was 132.6 packages, slightly higher than the national rate of 132.0 packages. Comparable data for fiscal year 1976, however, indicates that Illinois' consumption had increased to only 134.4 packages, while the national rate had risen to 145.3 packages. There was a decline nationally following the U.S. Surgeon General's report in 1964 that smoking could cause cancer, but that decline was only slight and shortlived.

If Illinois had been at the national per capita consumption rate of 145.3 packages, revenues would have been approximately \$194.3 million. Our actual collections were \$176.9 million, a difference of \$17.4 million.

In 1973, the Department estimated that cigarette tax loses to bootlegging amount to \$25 million annually. Noting a decline in revenues that could not be explained by national usage statistics, the Department began using a provision of the Cigarette Tax Act to seize vehicles found carrying contraband cigarettes. The downward trend in revenues was reversed, and cigarette tax collections within the same year, fiscal 1974, exceeded by about \$8 million the amount collected in the previous year.

These figures bear a relationship to a study by Professor Michael D. Maltz of the University of Illinois at Chicago for the Organized Crime Section of the federal Law Enforcement Assistance Administration. Using a regression formula, Professor Maltz looked for the difference in tax-paid sales and estimated consumption for each state. Introduced into the formula were equations to solve for net estimated imports and exports from each state. According to his findings, Illinois in 1974 lost \$16.06 million to cigarette smuggling.

Professor Maltz, incidentally, points out that per capita consumption of cigarettes has risen over the years, indicating that differences in statistics on usage are caused not by changes in the rate of consumption but by sales.

According to the statistics of the Advisory Commission on Intergovernmental Relations, the average per capita consumption in Illinois in 1975 was 131.8 packages of cigarettes. This compares to the national average of 139.2 packages and the average of Illinois and her five adjacent states of 147.8 packages.

It seems reasonable to assume that Illinois, often called a microcosm of the nation, should be at least at the national rate of consumption. But it is 5.614 percent below that level. With cigarette revenues in calendar 1975 totaling \$174,477,581, this would mean that the state's lost revenue in that year amounted to \$9,795,171.

We believe, however, that Illinois, because of its tourist and convention attractions, should be at or above the average of its neighboring states, which is 147.8 packages per capita consumption. Illinois is 12.139 percent below that level, which would mean an estimated revenue loss of \$21,179,833 in 1975.

The more recent statistics by the Federation of Tax Administrators indicate similar results. The FTA's statistics are based on consumption by persons 18 and older, which is the reason average consumption figures appear higher than the Advisory Commission's.

According to the FTA's statistics, the national average per capita consumption in 1976 was 201.65 packages of cigarettes, and the average consumption in Illinois and her five neighboring states was 219.04 packages. Illinois' average was



190.5 packages, 5.853 percent below the national average and 14.981 percent below the regional average. In dollars, these differences would mean revenue losses in 1976 of \$10,268,772 at the national average and \$26,283,356 at the regional average.

These are not the only revenue losses. State and local governments also lose sales tax revenues to bootlegging since cigarettes sold in Illinois for use here are subject to state and local sales taxes. When cigarettes are bought in another state and used in Illinois, the user remains liable for state taxes, but unless he remits them voluntarily, we have no adequate way of collecting them unless the purchase was by mail. In that case, the federal Jenkins Act, which will be described shortly, is extremely helpful.

Cigarette smuggling also costs business in Illinois millions of dollars. If the average retail price of cigarettes (excluding the cigarette tax) is 35 cents per package, smuggling into Illinois cigarettes bought in another state means a loss of between \$30 million and \$75 million annually to Illinois business.

It should be pointed out that some relief to the problem of casual smuggling in the Chicago area came July 1, 1977. At that time, Indiana's tax rate was increased to 10.5 cents per package. That reduced the differential between Illinois and Indiana taxes to 1.5 cents and the differential including Chicago's tax to 6.5 cents.

We do not expect the Indiana tax increase to have much effect on smuggling by organized crime, since our belief, confirmed by analyses like those of Professor Maltz, is that those contraband cigarettes are coming directly from the tobacco-producing states. The fact that Kentucky, for example, had an average per capita consumption of 330.8 packages in 1976 (Illinois' was 190.5) clearly indicates this.

#### IMPORTANCE OF FEDERAL CONTRABAND LEGISLATION

With the above points in mind, the question becomes: How would measures like those offered by Senator Bellmon and Congressman Railsback assist the states in halting the flow of contraband cigarettes and the loss of tax revenue? A case history will illustrate.

On December 23, 1976, agents of the Illinois Department of Revenue and the Illinois Bureau of Investigation seized more than 20,000 cartons of cigarettes bearing counterfeited Illinois cigarettes stamps. The contraband cigarettes were discovered and seized in eight suburban Cook County retail outlets.

The quality of the stamps and the method of distribution—we were unable to determine whether the retailers knew that the stamps were counterfeit or were selling what they believed were legitimate cigarettes—indicated that the operation was well organized and well financed.

American Decal, the manufacturer of the stamp, and Illinois and other states that used similar stamps believed it was foolproof. Illinois' discovery was the first indication that a highly secure stamp could be compromised. Our attempts to locate the source of cigarettes and the counterfeiting operation have been unsuccessful.

Our investigation determined that there had been no cigarette hijackings in the state, which we thought might have been a source of the cigarettes. And since we are able to monitor the flow of cigarettes from distributors within the state, we were able to determine that the contraband cigarettes appeared to have been from another source. The investigation pointed to a source from outside Illinois, but our ability to carry on the investigation stopped at our border.

Had there been a federal contraband law like that embodied in the Bellmon and Railsback bills, we could have sought assistance from the federal government to pursue the counterfeiters and distribution operations. These would have been federal crimes.

Under these bills, cigarettes transported interstate would have to be identified. The transporter would be required to have in his possession a bill of lading, which indicates the seller, buyer, origination, and destination of cigarettes.

These requirements would tie in nicely to a provision of the Illinois Cigarette Tax Act (Section 9c) that requires persons to have a permit from the Department of Revenue to transport in Illinois more than 2,000 cigarettes not taxed by the state. The provision, which was upheld in November 1976 by the Illinois Supreme Court, requires a transporter to give the Department advance notice of his intention to transport in Illinois untaxed cigarettes. It also gives the Department the ability to determine the disposition of transported cigarettes which enables us to check for any tax liability.

The contraband legislation would require dealers to maintain records of shipment, receipt, sale, and disposition of cigarettes, which would be available to the Secretary of the Treasury for inspection. This would allow the states to work through the federal government in obtaining information about cigarettes shipped interstate by or from dealers, again making it possible to monitor the flow of cigarettes for tax purposes.

I think it is important to point out that a contraband law would not be the first time the federal government has assisted the states with the collection of cigarette taxes. The federal Jenkins Act has been a significant tool for the states in halting cigarette mail order operations aimed at evading state tax laws.

Under the Jenkins Act, operators of cigarette mail order firms are required to register with a state in which mail order business is conducted. The operator also must provide to the state a list—including names, addresses, and quantities of cigarettes purchased—of customers residing in that state. These lists enable the states to collect taxes owed.

For Illinois, the Jenkins Act has worked well. Of the tax bills we have issued, based on lists of Illinois sales from mail order firms, virtually all have been paid without question.

Federal involvement in the administration of cigarette tax laws of the states is an important contribution to the deterrence of tax fraud. The states, with a federal contraband law, would have a way of dealing with interstate cigarette bootlegging and with organized crime, where it is involved in such operations.

We do not anticipate any reduction in our efforts to combat smuggling. Federal contraband law would strengthen those efforts and make our work more effective.

Let me conclude by saying I greatly appreciate the time and attention you have given this matter and hope you will feel free to call on me at (217) 785-2602 for any further information. I hope you will agree with me that the federal contraband measures have significant merit and purpose.

Sincerely yours,

ROBERT M. WHITLER,  
*Director of Revenue.*

STATE OF TENNESSEE,  
DEPARTMENT OF REVENUE,  
*Nashville, Tenn., December 8, 1977.*

SUBCOMMITTEE ON CRIMINAL LAW AND PROCEDURES,  
*Committee on the Judiciary, U.S. Senate,*  
*Washington, D.C.*

GENTLEMEN: In response to the request from the late Honorable John L. McClellan, Chairman, Subcommittee on Criminal Law and Procedures, for a statement of the effect cigarette "bootlegging" has had upon the states, let me first express my appreciation for the concern shown by the Subcommittee about this problem.

I am greatly concerned with the loss of revenue by the State of Tennessee due to the spread of cigarette "bootlegging". Tennessee, which has a cigarette tax of thirteen cents per package, is bordered by the three states with the lowest tax rates in the nation; North Carolina, two cents; Virginia, two and one-half cents; and Kentucky, three cents. Cigarette stands and truck stops in these three states near our state line do a thriving business in the sale of cigarettes. In addition, we also have the problem of individuals in the business of cigarette "bootlegging". Based on a 1975 study, if in the State of Tennessee an amount of cigarettes were sold equal to the national average per capita consumption, the State's loss in excise tax is approximately 7.2 million yearly.

We believe that our major loss of tobacco tax revenue is from citizens of Tennessee buying cigarettes in the above-mentioned states, rather than organized crime involvement. We have experienced local individuals being engaged in the business of "bootlegging" but they have had no known ties to organized crime. This may have been due solely to our closeness to the product. We have every indication from information developed during investigations in North Carolina that organized crime was involved in the shipment of cigarettes to the northern and northeastern states.

Due to our limited investigative manpower and the many roadways leading into the State from North Carolina, Virginia and Kentucky, it is impossible for the State to combat the problem of bootleg cigarettes, even though we do have

very good statutes, with both civil and criminal sanctions. State investigators are also greatly hampered by the lack of authority to conduct investigations outside the State, which, of course, would not be true in Federal law enforcement efforts.

For several years, many states have endeavored to curb the problem through cooperative local enforcement programs; however, these efforts have proven to be inadequate to stop the movement of bootleg cigarettes. The interstate nature of cigarette "bootlegging" places the individual states at too great a disadvantage to satisfactorily handle the problem.

In any proposed Federal legislation on cigarette "bootlegging", I feel that the cutoff limit of transported cigarettes should be fifty cartons (10,000 cigarettes) and that the penalty for unlawful transportation, receiving or possession of contraband cigarettes of more than fifty cartons should be, not more than \$10,000.00 fine, or imprisonment of not more than two years, or both.

I strongly recommend the enactment of a Federal contraband cigarette law. I will greatly appreciate your support of this legislation.

Sincerely,

JAYNE ANN WOODS.

DEPARTMENT OF JUSTICE,  
Washington, D.C., March 8, 1978.

HON. JAMES O. EASTLAND,  
Chairman, Committee on the Judiciary,  
U.S. Senate, Washington D.C.

DEAR MR. CHAIRMAN: This is in response to your request for the views of the Department of Justice on S. 1487, a bill "To eliminate racketeering in the sale and distribution of cigarettes, and for other purposes."

At the present time, the only statutory regulation of the interstate shipment of cigarettes is found in the Jenkins Act, 15 U.S.C. 375 *et seq.* That Act, which is designed to assist the states in collecting their cigarette taxes, requires, in part, that any person who sells or transfers for profit cigarettes in interstate commerce, whereby such cigarettes are shipped into a state taxing the sale or use of cigarettes, to other than a licensed distributor shall (1) file with the tobacco tax administrator of the state into which the shipments are made a statement setting forth his name and trade name and the address of his principal place of business and of any other place of business, and (2) file with the tobacco tax administrator before the tenth day of each month a memorandum or a copy of the invoice covering each shipment into that state during the preceding month. The memorandum or invoice must include the name and address of the person to whom shipment was made and the brand and quantity of cigarettes shipped. Any person who violates these filing and reporting requirements is punishable by a fine of not more than \$1,000.00 or imprisonment for not more than six months, or both. In addition, the United States district courts have jurisdiction to prevent and restrain violations of the Act.

The Jenkins Act applies primarily to cigarette distributors who send their cigarettes through the mails to customers in other states which tax the sale or use of cigarettes without complying with the filing and reporting requirements of the Act. It has limited usefulness for attacking the over-the-road "bootlegging" or smuggling operation by which the purchaser transports the cigarettes out of the state of purchase and surreptitiously brings them into another state for resale. Available evidence indicates that the states have been deprived of large revenues in lost cigarette taxes as a result of the latter type of operation.

S. 1487, whose stated purpose is to eliminate racketeering in the sale and distribution of cigarettes, would reach cigarette smuggling by making it unlawful to ship, transport, receive or possess "contraband cigarettes." The term "contraband cigarettes" is defined in the bill as a quantity in excess of 20,000 cigarettes, bearing no evidence of the payment of applicable state cigarette taxes in the state where the cigarettes are found, and which are in the possession of any person other than (1) a person holding a permit as a tobacco manufacturer or an export warehouse proprietor, or a person operating a customs bonded warehouse, or an agent of such person, (2) a common or contract carrier, (3) a person licensed to deal in cigarettes by the state where the cigarettes are found, or (4) an officer, employee, or agent of the United States or of any state or political subdivision having possession of cigarettes in the performance of his official duties. In addition, S. 1487 would require cigarette dealers to make and

maintain such records of shipment, receipt, sale, or other disposition of cigarettes as the Secretary of the Treasury may be regulations require and to make such records available for inspection. The term "dealer" is defined to mean any person who sells or distributes in any manner any quantity of cigarettes in excess of 20,000 in a single transaction. S. 1487 would make it a felony punishable by a fine of not more than \$10,000.00 or imprisonment for not more than two years, or both, to violate the prohibition on contraband cigarettes, to knowingly make any false statement or representation with respect to information required to be kept in the records of a dealer, or to violate any other provision of the law or regulations. Finally, S. 1487 would provide for seizure of contraband cigarettes.

For the reasons stated below, the Department of Justice recommends that S. 1487 be amended to reflect proposed changes contained in a draft bill prepared by the Bureau of Alcohol, Tobacco and Firearms, Department of Treasury, in close consultation with the Department of Justice. A copy of the draft is attached.

As you know, in the past the Department has opposed legislation like S. 1487. This opposition existed for two valid reasons. First, the Department believed that before there is a significant expansion of Federal criminal jurisdiction into an area hitherto reserved to the states, there should be a strong showing that the states have made significant, but unsuccessful, attempts to deal with the problem involved. In the past, the evidence had been that the states most affected by cigarette smuggling had not made significant attempts to deal with the problem. Second, past Administrations have not wanted to incur the costs, both investigative and prosecutorial, that would go with taking on primary enforcement responsibility for the collection of state cigarette taxes from interstate distributors and sellers of cigarettes. It was believed that passage of legislation like S. 1487 would create strong pressure for the assumption of that responsibility.

We continue to believe that many of the states most affected have not made serious commitments to the enforcement effort in this area. However, we do recognize that some states, most notably Pennsylvania and New York, have major enforcement programs, and that other states, like Connecticut, Florida and Ohio, have strengthened their efforts in recent years. This is illustrated by information provided in January 1978 by the Advisory Commission Intergovernmental Relations ("ACIR"). A copy of a January 20, 1978 memorandum to us from ACIR is attached. The effectiveness of this increased enforcement activity is unknown at the present, since much is of recent origin.

We continue to believe strongly that primary efforts to stop cigarette smuggling must be made by the states affected. However, we recognize that federal legislation in aid of state enforcement efforts may be desirable, if not essential, in light of the interstate nature of the problem.

In response to the Department's historical opposition, recent attempts to justify legislation like S. 1487 have made the argument that cigarette smuggling is an organized crime problem. For example, according to a report on cigarette bootlegging dated May 1977, which supported legislation similar to S. 1487, the ACIR noted that four New York crime families employing more than 500 enforcers, peddlers and distributors smuggle an estimated 480 million packs of cigarettes into the State each year. See page 21 of the ACIR report entitled "Cigarette Bootlegging: A State and Federal Responsibility."

We believe there is evidence that organized criminal elements are involved in cigarette smuggling. Since significant sums of money can be acquired at relatively little risk, this is an attractive area for such elements. Thus, the Department is prepared to support S. 1487, if modified to improve its potential effectiveness in dealing with the organized crime problem.

In recognition of the facts that the states have increased their enforcement activity, yet still need help, and that there is legitimate concern over organized crime's involvement in this area, we have had meetings with officials from the Department of Treasury in an effort to develop an approach acceptable to us. The proposed modifications to S. 1487 contained in the attached draft bills are the result of these meetings.

The draft bill would modify S. 1487 in only three significant areas. First, the draft bill defines the term "contraband cigarettes" as a quantity in excess of 30,000 cigarettes, rather than 20,000 cigarettes. Second, the draft bill contains different language with respect to the making of reports to the Secretary of the Treasury. S. 1487 would give the Secretary the discretionary authority to require "dealers" to maintain such records as prescribed by the Secretary.



The term "dealer" is defined as any person who sells or distributes in any manner 20,000 or more cigarettes in a single transaction. The draft bill would eliminate the "dealer" concept and simply require "any person" possessing, selling, distributing, carrying, transporting, purchasing or receiving 30,000 cigarettes or more in a single transaction to prepare such records and make such records as the Secretary may prescribe. Third, the draft bill would increase the penalties for violators. It provides that whoever unlawfully distributes, etc., contraband cigarettes would be subject to a fine of \$10,000 and/or five years in jail, and whoever violates any other provision of the law or knowingly makes a false statement or representation in a record required by the Secretary would be subject to a fine of \$5,000 and/or three years in jail. S. 1487 provides for a fine of \$10,000 and/or two years in jail for any violation of its provisions.

The 20,000 cigarette figure used in S. 1487 to define "contraband cigarettes" is a recognition that certain minor, untaxed cigarette smuggling, whether by users or by small-scale sellers is virtually impossible to control and not of significance to the Federal government. However, to the extent that S. 1487 is rationalized as an attempt to attack major organized crime, the Department believes the 20,000 cigarette figure, which translates into 100 cartons, is too low in relation to the type of significant organized criminal activity with which the Federal government is concerned. The figure of 30,000 cigarettes, which not a major change in the bill's coverage, is, in our view, an improvement.

The draft bill clarifies the Secretary's power to require the keeping of records and the making of reports. While no specific regulations have been prepared, this feature of the draft bill is intended to supply the Secretary with discretion to require record keeping that could be used to assist the state's enforcement efforts.

Finally, it is important to understand that criminal prosecutions under S. 1487, should it be enacted, would be reserved, as a matter of policy, for serious organized criminal involvement in cigarette smuggling and, in appropriate cases, for making false statements in required reports and records. Thus, we contemplate only selective use of the criminal sanctions. This is consistent with the Department's view that it does not have the resources to prosecute the routine or minor violators. The increased penalties in the draft bill over those currently provided in S. 1487 reflect the fact that we contemplate prosecutions of major violators only.

In summary, the Department's willingness to support S. 1487 as modified by the draft bill is based on a desire to facilitate the states' cigarette tax enforcement efforts, and to give us another weapon against organized crime. We envision, should the bill be enacted, that the states would continue to bear primary enforcement responsibility in this area.

For the reasons indicated above, the Department of Justice recommends enactment of S. 1487 if amended to incorporate the new provisions contained in the attached draft.

The Office of Management and Budget has advised that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

PATRICIA M. WALD,  
Assistant Attorney General.

Enclosure.

A Bill to eliminate racketeering in the sale and distribution of cigarettes, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

#### STATEMENT OF FINDINGS AND PURPOSE

SEC. 1. (a) The Congress finds that—

(1) there is a widespread traffic in cigarettes moving in or otherwise affecting interstate or foreign commerce, and that the States are not adequately able to stop the movement into and sale of such cigarettes in violation of their tax laws through the exercise of their police power;

(2) there is a causal relationship between the flow of cigarettes into interstate commerce to be sold in violation of State laws and the rise of racketeering in the United States;

(3) an expanded Federal role in the fight against cigarette smuggling is essential if there is to be an effective law enforcement effort against cigarette smuggling since the interstate nature of the crime places individual States at too great a disadvantage to handle these problems effectively;

(4) certain records maintained by persons possessing, selling, distributing, carrying, transporting, purchasing or receiving cigarettes could have a high degree of usefulness in criminal, tax, and regulatory investigations.

(b) It is the purpose of this Act to provide a timely solution to a serious organized crime problem and to help provide relief to many cities and States.

SEC. 2. Title 18, United States Code, is amended by inserting immediately after chapter 59 thereof the following new chapter:

#### "Chapter 60.—CIGARETTE TRAFFIC

"Sec. 1285. Definitions.  
"1286. Unlawful acts.  
"1287. Recordkeeping and Reporting.  
"1288. Penalties.  
"1289. Effect on State law.  
"1290. Enforcement and Regulations.

#### "§ 1285. Definitions

"As used in this chapter—

"(a) the term 'cigarette' means—

"(1) any role of tobacco wrapped in paper or in any substance not containing tobacco, and

"(2) any role of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in paragraph (1)

"(b) the term 'contraband cigarettes' means a quantity in excess of thirty thousand cigarettes, bearing no evidence of the payment of applicable State cigarette taxes in the State where they are found and which are, in the possession of any person other than (1) a person holding a permit issued pursuant to chapter 52 of title 26, United States Code, as a manufacturer of tobacco products or as an export warehouse proprietor or his agent; (2) a common or contract carrier: *Provided, however,* That the cigarettes are designated as such on the bill of lading or freight bill; (3) a person licensed or otherwise authorized by the State where the cigarettes are found to deal in cigarettes and to account for and pay applicable cigarette taxes imposed by such State; or (4) an officer, employee, or other agent of the United States, or its departments and wholly owned instrumentalities, or of any State or any department, agency, or political subdivision thereof.

"(c) the term 'common or contract carrier' means a carrier holding a certificate of convenience or necessity or equivalent operating authority from a regulatory agency of the United States or of any State or the District of Columbia.

"(d) the term 'State' includes a political subdivision thereof and the District of Columbia.

"(e) the term 'Secretary' means the Secretary of the Treasury or his delegate.

"(f) the term 'person' means any individual, corporation, company, association, firm, partnership, society, or joint company.

#### "§ 1286. Unlawful acts

"It shall be unlawful for any person to possess, sell, distribute, carry, transport, purchase or receive contraband cigarettes.

#### "§ 1287. Recordkeeping and reporting

"(a) Any person possessing, selling, distributing, carrying, transporting, purchasing or receiving in a single transaction a quantity of 30,000 cigarettes or more may be required to prepare and maintain a record of such transaction in such form and manner and for such duration as the Secretary may by regulations prescribe. Such records shall be made available for inspection in such manner as the Secretary may by regulations prescribe.

"(b) Any person possessing, selling, distributing, carrying, transporting, purchasing or receiving in a single transaction a quantity of 30,000 cigarettes or more may be required to report such transaction to the Secretary in such form and manner as the Secretary may by regulations prescribe.

"(c) The Secretary may enter the premises (including places of storage) of any person required to maintain a record of, and report, cigarette transactions under this section for the purpose of inspecting or examining (1) any records or documents required to be kept by such person, and (2) any cigarettes kept or stored by such person at such premises. Upon the request of any State or any political subdivision thereof, the Secretary may make available to such State or any political subdivision thereof, any information which is obtained by reason of the provisions of this chapter with respect to the identification of persons within such State or political subdivision thereof who have purchased or otherwise acquired cigarettes.

#### "§ 1288. Penalties

"(a) Whoever violates section 1286 of this chapter shall be sentenced to a fine of not more than \$10,000, or imprisoned not more than five years, or both.

"(b) Whoever violates any other provision of this chapter or regulations promulgated thereunder or knowingly makes any false statement or representation with respect to the information required by the provisions of this chapter to be kept in the records of a person by this chapter shall be sentenced to a fine of not more than \$5,000 or imprisoned not more than three, or both.

"(c) Any contraband cigarettes involved in any violation of the provisions of this chapter shall be subject to seizure and forfeiture, and all provisions of the Internal Revenue Code of 1954 relating to the seizure, forfeiture, and disposition of firearms, as defined in section 5845(a) of the Code, shall so far as applicable, extend to seizures and forfeitures under the provisions of this chapter.

#### "§ 1289. Effect on State law

"Nothing in this chapter shall be construed to affect the concurrent jurisdiction of a State to enact and enforce State cigarette tax laws, to provide for the confiscation of cigarettes and other property seized in violation of such laws, and to provide penalties for the violation of such laws.

#### "§ 1290. Enforcement and regulations

"The Secretary shall enforce the provisions of this chapter and may prescribe such rules and regulations which are reasonably necessary to carry out the provisions of this chapter.

Sec. 3. (a) Except as provided in subsection (b), the provisions of chapter 60 of title 18, United States Code.

(b) The following sections of chapter 60 of title 18, United States Code, shall take effect on the date of enactment of this Act: Sections 1285, 1286, 1288, 1289, and 1290.

Sec. 4. The title analysis of title 18, United States Code, is amended by inserting immediately below the item relating to chapter 59 the following:

"60. Cigarette Traffic ----- 1285."

Sec. 5. (a) Section 1(b) of the Act of August 9, 1939, c. 618, 53 Stat. 1291, as amended (49 U.S.C. § 781(b)), is amended by (1) striking out "or" at the end of paragraph (2); (2) striking out the period at the end of paragraph 3 and inserting in lieu thereof "; or"; and (3) adding after paragraph 3 the following new paragraph 4 to read as follows:

"(4) Any cigarettes, with respect to which there has been committed any violation of any provision of chapter 60 of title 18 or any regulation issued pursuant thereto."

(b) Section 7 of the Act of August 9, 1939, c. 618, 53 Stat. 1291, as amended (49 U.S.C. § 787), is amended by (1) striking out "and" at the end of subsection (e); (2) striking out the period at the end of subsection (f) and inserting in lieu thereof "; and"; and (3) adding after subsection (f) the following new subsection (g) to read as follows:

"(g) The term 'cigarettes' means 'contraband cigarettes' as now or hereafter defined in section 1285(b) of title 18."

## ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, Washington, D.C., January 20, 1978.

### MEMORANDUM

To: Robert E. Courtney III, attorney, Government Regulations and Labor Section, Criminal Division, Department of Justice, Washington, D.C.  
From: John Shannon, Assistant Director, Taxation and Public Finance Section, Advisory Commission on Intergovernmental Relations.  
Subject: Summary of State response to Justice Department inquiry concerning the States' efforts against cigarette bootlegging.

#### AVAILABILITY OF INFORMATION REQUESTED BY JUSTICE DEPARTMENT

In a substantial measure, the information requested by the Justice Department from the states with respect to cigarette tax enforcement costs attributable to bootlegging are not available, because state revenue departments are frequently organized on a functional rather than a tax division basis and departmental data are maintained on a collective, rather than on a tax-by-tax basis. Also, in those states which are structured on a tax division basis, the cigarette tax is often the responsibility of a division which administers several excise taxes and here, too, administrative and enforcement data are not broken down by the type of tax.

In states which revenue departments are organized on a functional basis, or in which the cigarette tax is administered together with other taxes, operations, equipment, and personnel are used collectively in administering all or several taxes. Unless the department or division makes a special analysis of these operations, it cannot assign a percentage of total costs to specific taxes. This also applies to state investigative programs. Many states, which in the past had audit and investigative staffs assigned to each tax division, have established unified special investigative units which are concerned either with all taxes or with a combination of taxes.

#### COMPARATIVE DATA ON CIGARETTE TAX ENFORCEMENT OR ON THE EFFORT AGAINST SMUGGLING IN THE LAST 5 YEARS

For the reasons previously stated, for most states, spending data are non-segregable. However, reports are available from a number of states on spending, staff size and deployment, or on organizational developments which relate to activity of this type.

*Connecticut.*—A special investigations section has been formed in the state tax department, principally to combat cigarette smuggling. Although the section deals with all state tax frauds, all agents are trained in cigarette smuggling investigations, they have full state police powers, and all attend the state police academy before receiving such powers. Special investigations section personnel work closely with state and local police.

*Florida.*—A cigarette strike force has been established which includes seven officers assigned full time to cigarette bottlegging. The department has requested seven additional officers in its budget for fiscal 1978-79. Florida joined the Interstate Revenue Research Center on July 1, 1977, and has expended \$16,800 thus far for this purpose.

*Minnesota.*—In 1976, a professional staff of six, assigned to the audit and collection of cigarette taxes, was augmented by the hiring of two trained criminal investigators. In 1977 two more investigators were added to this staff. Minnesota, in 1977, has made two payments of \$17,500 and \$16,800 to the IRRC. In addition to investigation and prosecution responsibilities, the investigative force has developed a cigarette smuggling educational program on the organized aspects of smuggling for the general public.

*New Jersey.*—Since 1972, the New Jersey Division of Taxation's special investigations unit has added 20 special agents, an increase of about 50 percent in the size of its staff. The special agents have been given the power of arrest and the right to carry firearms. Penalties for cigarette tax violations have been strengthened. The New Jersey Division of Taxation has had a major role in the formation of the Eastern Seaboard Interstate Cigarette Tax Enforcement Group, and its special investigators have conducted a course on cigarette smuggling at the State Police Training Academy.

*New York.*—The New York Department of Taxation and Finance does not maintain separate records on its cigarette tax investigative work. However, the payroll cost of cigarette tax investigators is about two-thirds of the entire bureau, and about 80 percent of non-personnel costs are attributable to the smuggling effort. On that basis, the approximate outlay for cigarette tax investigation rose from \$919,000 to \$1,029,000 between fiscal 1973 and fiscal 1977. Man-days devoted to cigarette tax enforcement approximated 18,000 in fiscal 1977.

*Ohio.*—The Ohio Department of Taxation now has 12 investigators assigned to cigarette tax evasion. In 1971, it employed no cigarette tax investigators. In addition, Ohio has strengthened its cigarette tax enforcement effort by providing for felony convictions, police powers for enforcement personnel, and informers' fees. Between 1972 and 1977, expenditures for the administration of cigarette taxes rose from \$191,020 to \$590,776. Over the same period the amount spent to combat cigarette smuggling rose from \$71,600 to \$311,800. On a man-year basis, the increase was from 4½ in 1972 to twelve in 1977. Ohio has made two payments of \$17,500 and \$16,800 to IRRC.

*Pennsylvania.*—Between fiscal 1973 and fiscal 1977, the Pennsylvania Department of Revenue has increased its expenditures for the enforcement of cigarette contraband laws from \$672,000 to \$1,191,000. Over the same period, the number of special investigators assigned exclusively to cigarette contraband enforcement has ranged between 51 and 59. The department also had committed \$25,000 for use in Eastern Seaboard Interstate Cigarette Tax Enforcement Group, but did not apply those funds because of LEAA's rejection of the ESICTEG's application for grant money.

*Washington.*—Between fiscal 1973 and fiscal 1977, Washington has increased its expenditure for cigarette tax administration enforcement from \$122,567 to \$172,854. Amounts spent for enforcement relating to the sale of untaxed cigarettes rose from \$43,000 to \$62,000. Three man-years annually are devoted to cigarette tax evasion.

*Wisconsin.*—Data not segregable. In January, 1977, four additional enforcement personnel were assigned to combatting cigarette smuggling. A basic field investigative staff is also concerned with alcohol and tobacco enforcement. Wisconsin has also developed an intensive training program for state and municipal enforcement agencies in this area.

**END**