

## MINNESOTA • REVENUE

February 19, 2014

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To the members of the Legislature of the State of Minnesota:

Minnesota Laws, Chapter 143, Article 5, Section 27, requires the Commissioner of Revenue to report on Minnesota's tobacco tax collection system, including recommendations to improve compliance under the excise tax for both cigarettes and other tobacco products.

The Department engaged an independent evaluator, JD Michael, to conduct this study of how the Department currently administers and enforces cigarette and tobacco taxes in Minnesota. The following study examines:

- Our existing penalties and compliance/enforcement resources.
- How Minnesota compares to other states and nations.
- Potential options to improve tax compliance, discourage tax evasion, and reduce illegal sales of cigarettes and other tobacco products (including sales to minors).
- Specific changes Minnesota can make to improve our system, and how to pay for them.

Major findings include that Minnesota has sound procedures for licensing, stamping, returns, forms, assessment and inspection. Minnesota's administration staff is knowledgeable, well educated, and well trained. Taxpayer-education programs are excellent and training materials are thorough, easy to read, and easy to understand.

The study also makes suggestions on improving Minnesota's solid administration infrastructure. The study's discussion of these recommendations should prove helpful in future policy discussions. In particular, the Department of Revenue supports the following recommendations:

1. License all cigarette and tobacco retailers at the state level. This will help the Department address compliance issues consistently from manufacturers, to distributors and subjobbers (wholesalers), to retailers.
2. Increase our license fees for cigarette and tobacco distributors and subjobbers. Minnesota's fees have not been adjusted since 1990 and are below the state surveyed averages; increasing them will help fund increased enforcement and outreach in a sustainable way.
3. Increase criminal and civil penalties for the delivery or possession and sale of untaxed cigarette and other tobacco products (OTP). This will discourage the illegal transport and sale of contraband (untaxed) cigarettes and OTP in Minnesota. The Department favors a tiered approach, with fines based on the number and severity of offenses, to provide progressive enforcement.
4. Require stamping of moist snuff products to provide greater ability to track sales and enforce tax laws. Moist snuff is the highest-selling tobacco product after cigarettes and is easier to stamp than some other products due to its uniform packaging.
5. Establish civil penalties for failure to keep proper books, records, invoices, or operating without a valid cigarette and tobacco license. Other states, like Illinois, have this penalty already. This will increase compliance with record-keeping requirements by allowing inspectors to issue a ticket or fine for non-compliance during or right after an on-site inspection.
6. Set up a separate cigarette and tobacco tax inspection/enforcement unit, similar to what other states are doing. Inspections and audits complement each other but require different skillsets. Separating these functions will make each more effective so the Department can more effectively address illegal transport or sale of cigarette and OTP; this illegal trafficking has risen in other states that increased their excise taxes.
7. Expand the definition of "other tobacco products" to include any product containing nicotine from any source. This will preserve the intent of our existing law as it applies to e-cigarettes. Some manufacturers try to avoid the OTP tax by claiming to extract nicotine from non-tobacco sources (such as tomatoes or eggplant).

8. Clarify the definition of an “unlicensed seller” to explicitly include anyone that is not a licensed products distributor, whether they are in- or outside of Minnesota. This will ensure the illegal importation statutes apply equally to anyone that sells untaxed cigarettes and tobacco products, regardless of where – and from whom – the products were purchased.
9. Give the Department more authority to suspend, cancel, revoke, or not renew a cigarette or tobacco license. This will increase our ability to uphold the law when an applicant or license holder has been convicted of a felony, received a business-related tax fraud penalty, or purchased inventory from an unlicensed seller.

The Department’s mission is to gain compliance with tax laws to fund public services for Minnesota. The Department’s strategies include taxpayer service and education, designing systems that align with technology changes, identifying non-compliant taxpayers, and measuring results to make improvements to achieve positive outcomes.

I hope you find the attached study useful as we work together to reach our shared goal of continuous improvements to the tobacco tax collection system. Please feel free to contact me if you have any questions.

Sincerely,

A handwritten signature in blue ink, appearing to read "Myron Frans". The signature is fluid and cursive, with a large initial "M" and "F".

Myron Frans  
Commissioner

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# A Study of Minnesota's Tobacco Tax Collection System

A report to the Minnesota Legislature in accordance with  
Minnesota Laws 2013, Chapter 143, Article 5, Section 27

Prepared by:  
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Submitted on February 14, 2014 to:  
**Minnesota Department of Revenue**  
**Special Taxes Division**

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# Executive Summary

The 2013 Minnesota Legislature passed cigarette and tobacco tax rate increases, effective July 1, 2013. This legislation required the Minnesota Department of Revenue (MDOR) to commission a report on the current tobacco tax collection system and make recommendations to improve tax compliance for cigarettes and other tobacco products (OTP). In September 2013, the Minnesota Department of Revenue selected JD Michael, a state and local tax consulting firm, to produce this report. Information contained in this report is derived from research that was performed from September to December 2013.

Minnesota has the seventh highest excise tax rate among the states and the highest excise tax rate among the states bordering Minnesota. While MDOR has a comprehensive tax collection system in place, this report reviews the department's current approach, and makes recommendations when necessary, to address potential increases in tax avoidance and evasion that will arise as a result of the recent tax changes. Major areas reviewed are tax processing, inspections, audits, and enforcement. Specific initiatives are identified in Section 8.

Section 1 of the report contains results of an in-depth assessment of MDOR's cigarette and tobacco tax compliance systems. Major findings are:

- Sound procedures and processes for licensing, stamping, returns, forms, assessment, and inspection are in place.
- Cigarette and other tobacco products tax administration staff is knowledgeable, well-educated, and well-trained.
- Cigarette and OTP training materials for staff are thorough, easy to read, and easy to understand.
- Taxpayer-education programs provided by MDOR in the area of cigarette and tobacco products tax administration are excellent. All new cigarette and tobacco products taxpayers receive an on-site visit from MDOR staff, educational materials, and tax return preparation training.
- To maintain high levels of quality audit and enforcement activity, increases are needed to staffing levels in the areas of auditors, inspectors, and criminal investigators.

Section 2 of the report contains a review of MDOR's fiscal estimates associated with the recent cigarette and tobacco tax changes. Using case-study and survey techniques, JD Michael finds that MDOR's revenue estimates are reasonable and can be substantiated based on other states' experiences and academic literature. Survey results indicate that, prior to the tax increases, estimated compliance rates in Minnesota are comparable to the average for the survey states. Cigarettes have the highest compliance rate (95 percent). In general, tobacco products' compliance is lower than for cigarettes. MDOR's compliance rates are average or above average for all categories other than unstamped cigars.

Section 3 of the report contains analysis of survey results received from a select group of states. The states were selected because they met one or more of the following criteria: border state; high tax state; or a state with innovative enforcement practices. Responses were received from 11 states (including Minnesota) and one city. Based on survey results, several options for MDOR to enhance its current system of cigarette and OTP tax administration and enforcement were identified including:

- License retailers at the state level.
- Adjust existing license fees. In many instances MDOR fees are below the average of the states surveyed.
- Treat cigarette and tobacco products sub-jobbers as distributors in terms of licensing and reporting.
- License all stages of the supply and distribution chain, from manufacturers to retailers, for both cigarette and tobacco products.
- Evaluate stamping tobacco products that do not currently require a stamp.
- Increase resources to allow for regular scheduled and unscheduled inspections at all levels of the supply and distribution chain (from manufacturers to retailers).
- Conduct detailed cost-benefit analysis of introducing a high-technology stamp.
- Increase the resources allocated to criminal investigations.
- Increase civil and criminal fines and penalties. These are discussed further in Section 4 and Appendix J of the report.

Section 4 of the report presents MDOR's existing statutory fines, penalties, criminal charges, or sanctions and contrasts them with those in the survey states. These comparisons are used as the basis for recommending changes to MDOR's existing fine and penalty structure. Areas identified for possible changes include:

- Failure to File or Pay Tax
- Knowingly Failure to File or Pay Tax
- Failure to Keep Records
- Counterfeit Stamps
- Counterfeit Cigarettes/Papers or Gray Market Cigarettes/Papers
- Unstamped Cigarettes; Untaxed Tobacco Products; Contraband
- Operating Without a License/Sales After License Revocation
- Refusal to Permit Authorized Examination or Inspection
- License Suspension or Revocation
- Seized/Forfeited Property
- Personal Liability
- Prohibited from Purchasing, Possessing, or Selling any Cigarettes or Other Tobacco Products

Section 5 of the report addresses the specific question posed by the legislature — what can Minnesota do to “help to prevent illegal sale of tobacco products, which may make these



products more accessible to youth?” Research suggests that actions to increase overall enforcement efforts will go a long way to address this issue. Some unique recommendations discovered during this phase of the research include:

- Coordinate regular enforcement with efforts to stop illegal sales to youth.
- Explore partnerships between public health, law enforcement, and revenue agencies.
- Monitor trends in e-cigarettes, given that they are outlawed in some countries.

Section 6 of the report discusses available options to stamp, track and trace cigarettes and tobacco products. In recent years, increased competition has occurred in the high-technology stamp market, creating new options and resulting in lower costs. MDOR should consider conducting a detailed cost-benefit analysis of introducing a high-technology stamp. In conducting a cost-benefit analysis, rather than thinking of high technology stamps as a solution in and of itself, MDOR will need to enhance its compliance strategy to include licensing at all levels of the supply and distribution chain, performing more frequent scheduled and unscheduled inspections, and reviewing civil and criminal fines and penalties.

Section 7 of the report consists of examples of innovative enforcement strategies found in other countries. Countries included in this section of the report were Australia, Brazil, Canada, China, Ireland and the United Kingdom, and the Ukraine.

Section 8 of the report includes a set of recommendations to strengthen cigarette and tobacco tax compliance in Minnesota. The recommendations are summarized below.

## **Recommendations**

**Current Operations:** MDOR should consider separating the cigarette and tobacco tax audit and civil inspection functions. Such specialization could increase work quality and productivity.

**Criminal Investigations:** MDOR should consider consolidating the criminal investigation functions within the Cigarette, Alcohol, and Tobacco area to further increase efficiencies.

**Enforcement Resources:** MDOR should consider increasing enforcement resources by adding five additional positions (three non-criminal inspector positions and two criminal investigator positions). We recommend this for two reasons. First, historic levels of civil inspections are not being achieved because personnel resources are being allocated to on-going testing of the new tax administration system (GenTax®). Second, in light of the recent tax increase, the number of scheduled, unscheduled, and criminal inspections for players at all levels of the supply and distribution chain should be increased.

**Cross Agency Working Groups:** To help leverage resources, JD Michael recommends that a working group is established with participants from other agencies directly or indirectly involved in similar activities such as County Attorneys' General, County Sheriff Departments, the State Attorney General, State Patrol, Minnesota Bureau of Criminal Apprehension, and the federal Bureau of Alcohol, Tobacco, Firearms, and Explosives. The goal of such a working group would be to improve prosecution results.

Legislative Changes: Also, JD Michael recommends several legislative changes to improve compliance and discourage tax avoidance or evasion. These changes are in:

- The definition of tobacco products
- The definition of an unlicensed seller
- Licensing
- Civil and criminal fines and penalties

## **Conclusion**

MDOR has a solid infrastructure in place for cigarette and tobacco tax administration. Additional personnel resources for civil and criminal inspections are needed in light of the recent tax increase. These costs could be partially defrayed by increasing existing license fees and licensing activities in the supply chain that are currently unlicensed. As part of increased enforcement efforts, consideration should be given to adopting a high-technology stamp. Finally, several statute changes should be adopted to help deter tax avoidance. Taken together, these actions will result in a comprehensive cigarette and tobacco tax compliance strategy.

# Acknowledgements

JD Michael would like to express our thanks to the Minnesota Department of Revenue staff who answered our questions and provided information included in this report.

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## **Tax Administration Staff**

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Michigan  
Montana  
New Jersey  
New York  
New York City  
North Dakota  
Ohio  
South Dakota  
Virginia  
Wisconsin

## **Research Staff**

California  
Delaware  
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Virginia

In addition, JD Michael would like to thank the following companies who provided information about their stamping products and the associated technology.

De La Rue  
Neenah Paper  
Sekuworks  
SICPA  
Xerox

The cooperation from these groups allowed JD Michael to fully address the questions posed by the Minnesota Legislature.

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# Introduction

The 2013 Minnesota Legislature passed Minn. Laws, Chapter 143, Article 5, Section 27. This legislation provided for the commissioner of the Minnesota Department of Revenue (MDOR) to commission a report on the current tobacco tax collection system and make recommendations to improve compliance for both cigarette and other tobacco products (OTP) taxes. The Minnesota Department of Revenue selected JD Michael, a tax consulting firm, to produce this report in September 2013 (See Appendix A for bios of the consulting team and Appendix B for details of specific legislation).

Section 1 of the 2013 Tobacco Tax Study (report) summarizes the findings of a detailed review and assessment of the current cigarette and OTP excise collection and compliance systems used in MDOR. It also identifies potential weaknesses in those systems.

Section 2 assesses compliance levels and the effect of stamping requirements on compliance rates between cigarette and OTP. Analysis contained in this section is derived from survey results obtained from Minnesota and 18 other states.

Section 3 presents survey results on collection and enforcement methods employed by other selected states and, where possible, compares these practices with those at MDOR.

Section 4 compares and contrasts MDOR's penalty and fine structure to similar statutory enforcement methods employed in comparison states.

Section 5 reviews research findings and recommendations on how to reduce the consumption of illicit tobacco by youth. It also contains primary research information obtained from groups working in the area of youth tobacco prevention.

Section 6 discusses current options for track and traces technologies.

Section 7 discusses innovative practices adopted by selected countries.

Section 8 evaluates the adequacy of enforcement resources devoted to tobacco tax and prevention in Minnesota, and makes recommendations on the specific steps needed to institute and implement new initiatives designed to increase compliance.

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# Section 1

## Review and Assessment of the Existing Tax Administration Process in Minnesota

A site visit was conducted by the consulting team from September 24 – 26, 2013, at the Minnesota Department of Revenue (MDOR). The purpose of the visit was to

- interview MDOR staff,
- gather information on current structures and processes, and
- analyze and assess the current tax administration and enforcement of cigarette and tobacco taxes.

The assessment began with tours of most processing areas at MDOR and was followed by staff interviews. Existing forms, process flows, statutes, procedures, and job descriptions were reviewed. (See Appendix C for overviews of each processing function and a detailed analysis of each area. See Appendix D for unit overviews and job descriptions.)

General observations made by the consultants include the following:

- The overall assessment indicates that sound procedures and processes for licensing, stamping, returns, forms, assessments, and inspections are in place.
- MDOR recently adopted an updated tax administration computer system (GenTax®) and continues to work with the developers to make improvements to the new system.
- The MDOR website is easy to use and provides comprehensive taxpayer information.
- Cigarette and other tobacco products (OTP) tax administration staff is knowledgeable, well-educated, and well-trained.
- MDOR makes a wide variety of electronic services available to taxpayers.
- Cigarette and OTP training materials for staff are thorough, easy to read, and easy to understand.
- Taxpayer-education programs provided by MDOR in the area of cigarette and OTP tax administration are excellent. All new cigarette and OTP taxpayers receive an on-site visit from MDOR staff, educational materials, and tax return preparation training.
- Procedures for inventory and sales of cigarette tax stamps are well thought out and in place, and provide a high level of separation of duties.
- Staff conducts regular unscheduled retail inspections.
- Staff conducts an annual random survey of retailers to establish a weighted annual average price for a pack of cigarettes, used to calculate the sales tax.

Some observations were made during the on-site visit that may warrant further investigation and attention. These items are listed below.

## Process Findings and Associated Recommendations

### Data Capture/Information Technology (IT)

- Finding 1:** Electronic filing is not currently available and data lifting is not currently used for license applications.
- Recommendation 1:** Develop an electronic filing application that allows a business to register for a cigarette or OTP license. Develop a promotional campaign to promote the available electronic services.
- Finding 2:** The data on paper cigarette and OTP returns are manually entered and MDOR does not have a mandatory electronic filing program.
- Recommendation 2:** Mandate electronic filing or explore using electronic-data capture (data imaging) of paper returns. Adoption of these technologies would reduce the amount of data entry and allow for resources to be allocated to other areas.
- Finding 3:** Information on shipments of products to locations outside of Minnesota (Form CT201-C) is not currently captured and stored in GenTax®.
- Recommendation 3:** Explore increased opportunities for electronic-information sharing (exchanging) with other states.
- Finding 4:** The cigarette and OTP license applications are manually reviewed to check for outstanding balances and open periods.
- Recommendation 4:** Consider automation of the license application review to automatically check for outstanding balances and open periods.
- Finding 5:** Minnesota statutes require that applicants for a cigarette or OTP license be checked for cigarette-related and tobacco-related crimes. MDOR does not have a systematic procedure in place to determine whether or not an applicant has been convicted of such a crime.
- Recommendation 5:** Establish a systematic process for the appropriate MDOR staff to initiate criminal background checks of license applicants. Research the possibility of using the Federal Bureau of Investigations' National Instant Criminal Background Check System or the State Police Criminal History Data Base to determine if an applicant has been convicted of a cigarette-related and tobacco-related crime.

### Licensing

- Finding 6:** Manufacturer and manufacturer representative licenses are not currently required by statute.
- Recommendation 6:** To assist in enforcement efforts, consider requiring manufacturers and manufacturer representatives to be licensed, pay a license fee, and file monthly, informational returns that can be used to cross check shipments

against distributor purchases. This process will assist efforts in product inventory accountability. **Adoption of such a proposal would require a legislative change.**

**Finding 7:** Licensing stickers are not required on cigarette or tobacco vending machines.

**Recommendation 7:** Licensing stickers could be issued and required to be displayed on cigarette or tobacco vending machines. Displaying a license sticker allows the state to know who is responsible for the machine and the products contained within.

**Finding 8:** Retailer licensing occurs at the city or county level. MDOR is not always provided information on the licenses that are issued.

**Recommendation 8:** MDOR could consider requiring state-level retail licenses to minimize tax evasion at the retailer level. Should this suggestion be adopted, and accompanied by a license fee, revenue generated could be used to cover the cost of additional retail inspections. **Such a proposal would require a legislative change.** In the meantime, city or county license information could be systematically captured in the GenTax® system. This will facilitate information sharing between MDOR and the licensing municipality regarding matters of evasion or seizure.

**Finding 9:** The statutes currently do not have a provision for an arm's length sales transaction to prevent individuals from conducting illegal activity, leaving the country, and selling the business to a relative.<sup>1</sup>

**Recommendation 9:** MDOR could consider providing for arm's length sales transactions. An "arm's length transaction" is defined as a sale in good faith and for valuable consideration that reflects the fair-market value in the open market between two informed and willing parties, neither under any compulsion to participate in the transaction. A sale between relatives or between related companies or partners, or a sale for the primary purpose of avoiding the effect of violations that occurred at the retail location, is presumed not to be made at "arm's length". **Such a proposal would require a legislative change.**

### **Stamping and Bonding**

**Finding 10:** MDOR does not change the cigarette stamp color or design frequently.

**Recommendation 10:** The stamp color and or design could be changed more frequently, as this makes it more difficult to produce counterfeit stamps and, as such, has a significant deterrence effect on illegal sales.

## Returns

**Finding 11:** MDOR does not require sub-jobbers to complete and file informational returns.

**Recommendation 11:** Sub-jobbers could be required to complete and file informational returns and the information could be captured and analyzed by the department's Cigarette, Alcohol, and Tobacco (CAT) Unit to ensure that the tax has been paid on all products that are handled by sub-jobbers.

**Finding 12:** Revenue Tax Specialists (RTS) in the CAT Unit are currently editing and correcting returns.

**Recommendation 12:** Editing and correcting returns could be performed by the Early Audit 1 Unit staff, thereby freeing up RTS resources to conduct more inspections and audits.

## Inspections

**Finding 13:** Ongoing GenTax® system testing is very labor intensive and requires considerable time from compliance and enforcement staff. Currently, five of the most experienced auditors have been reallocated to system testing.

**Recommendation 13:** In order to maintain historic levels of audits and unscheduled inspections (prior to tax increase) additional resources are needed to compensate for system-testing losses.

**Finding 14:** Staff conducts both audits and inspections.

**Recommendation 14:** Consider having staff specialize in either audit or inspection work and increase the number of inspections.

**Finding 15:** Inspections behind locked doors require the permission of the owner or sales clerk.

**Recommendation 15:** Allow more authority to inspect behind locked doors to ensure that contraband product is not being stored in areas that are inaccessible to inspectors. For example, a provision could be added to the statutory-licensing requirement that would permit authorized inspectors to access all areas of a licensed business. **Such a proposal would require a legislative change.**

**Finding 16:** Inspectors manually create paper reports for their inspections and reenter the information into GenTax®.

**Recommendation 16:** Explore creating a program that inspectors can use to enter data into laptops or tablets while in the field.

## **Criminal Investigations**

**Finding 17:** There is only one criminal investigator assigned to perform cigarette and tobacco investigations for the whole state of Minnesota and only about 3 to 5 criminal cases are presented annually for prosecution.

**Recommendation 17:** MDOR could review both the quantity of and the type of resources allocated to criminal investigations. In addition to criminal investigators, MDOR could consider hiring computer specialists to analyze data contained in computers seized from businesses who are in violation of the tax laws.

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# Section 2

## Review of Revenue Estimates, Methodologies, and Non-Compliance Rates

This section of the report provides a brief overview of cigarette and other tobacco products (OTP) taxation both at the federal and state level. This is followed by an examination of MDOR's official revenue estimates associated with the recent cigarette and OTP tax changes. Using survey results, the section concludes by assessing the levels of compliance and the effect of stamping requirements for each category of product.<sup>2</sup>

### Taxation in the United States on Cigarettes and Other Tobacco Products

An excise tax on cigarettes was first adopted by the federal government in 1864.<sup>3</sup> By 1951, it stood at \$0.08 per pack, and was then doubled to \$0.16 in 1983. This was followed by an increase to \$0.39 in 2002 and then \$1.01 in 2009. Federal excise tax is also levied on most OTP.

**Table 2-1 Federal Excise Tax on Other Tobacco Products**

	Amount of Excise Tax
<b>Cigars</b>	\$1.0066 per pack on small cigars (52.75 percent of the price for low-priced cigars with a cap of 40.26 cents per cigar for high-priced cigars)
<b>Chewing tobacco</b>	3.1 cents per ounce
<b>Moist snuff</b>	\$1.51 per pound
<b>Roll-your-own tobacco</b>	\$24.78 per pound
<b>Rolling papers</b>	1.26 cents per pack

Source: Tax Burden on Tobacco, Historical Compilation Vol. 47, 2012. Published by Orzechowski and Walker.

### Taxation in the States on Cigarettes and Other Tobacco Products

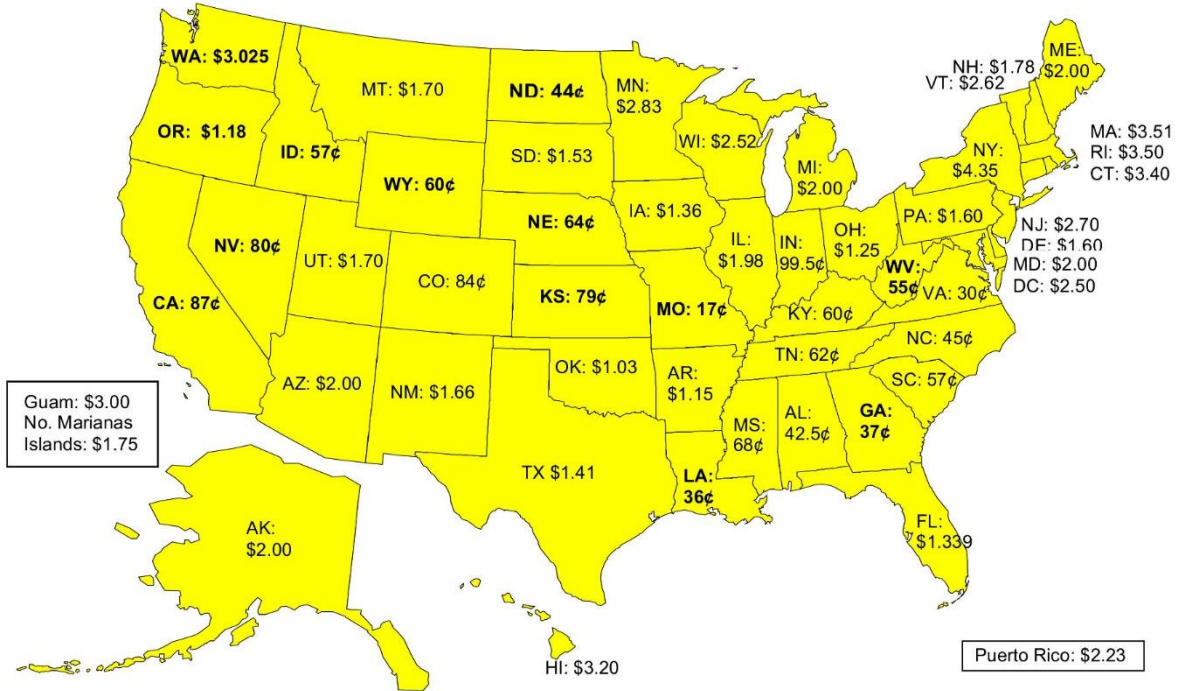
All fifty states tax cigarettes. State cigarette taxes were first adopted by Iowa in 1921, with North Carolina being the last state to adopt in 1969. The state levied excise taxes currently range from New York's \$4.35 per pack to Missouri's \$0.17 per pack. In addition, many localities add additional tax. This typically amounts to a few cents per pack with a few exceptions. For example, the per-pack tax in New York City is \$1.50, while in Chicago the current combined city and county tax rate is \$2.68.<sup>4</sup> This wide variation in tax rates is significant as it creates a strong incentive for evasion.

## MAP OF STATE CIGARETTE TAX RATES

**Average State Cigarette Tax: \$1.53 per Pack**

**Average Cigarette Tax in Major Tobacco States: 48.5 cents per Pack**

**Average Cigarette Tax in Non-Tobacco States: \$1.67 per Pack**



Source: *Campaign for Tobacco-Free Kids, August 1, 2013 / Ann Boonn* <http://www.tobaccofreekids.org/research/factsheets/pdf/0222.pdf>

Most states levy an ad valorem tax on OTP. In addition, a sales tax is applied to OTP in most states. There have been numerous state cigarette excise tax increases over the past 5 years.

**Table 2-2 State Cigarette Excise Tax Increases in the Last Five Years<sup>5</sup>**

	Effective Date	Amount of Increase	New Tax Rate
<b>2013</b>			
Massachusetts	7/31/13	\$1.00	\$3.51
Minnesota	7/01/13	\$1.60	\$2.83
New Hampshire*	8/01/13	\$0.10	\$1.78
<b>2012</b>			
Illinois	6/24/12	\$1.00	\$1.98
Rhode Island	7/01/12	\$0.04	\$3.50

	Effective Date	Amount of Increase	New Tax Rate
<b><u>2011</u></b>			
Connecticut	7/01/11	\$0.40	\$3.40
Hawaii†	7/01/11	\$0.20	\$3.20
New Hampshire	7/01/11	-\$0.10	\$1.68
Vermont	7/01/11	\$0.38	\$2.62
<b><u>2010</u></b>			
Guam	4/06/10	\$2.00	\$3.00
Hawaii†	7/01/10	\$0.40	\$3.00
New Mexico	7/01/10	\$0.75	\$1.66
New York	7/01/10	\$1.60	\$4.35
South Carolina	7/01/10	\$0.50	\$0.57
Utah	7/01/10	\$1.005	\$1.70
Washington	5/01/10	\$1.00	\$3.025
<b><u>2009</u></b>			
Connecticut	10/01/09	\$1.00	\$3.00
Delaware	8/01/09	\$0.45	\$1.60
Washington, DC	10/01/09	\$0.50	\$2.50
Florida	7/01/09	\$1.00	\$1.339
Hawaii†	7/01/09	\$0.60	\$2.60
Kentucky	4/01/09	\$0.30	\$0.60
Mississippi	5/15/09	\$0.50	\$0.68
New Hampshire	7/01/09	\$0.45	\$1.78
New Jersey	7/01/09	\$0.125	\$2.70
North Carolina	9/01/09	\$0.10	\$0.45
Pennsylvania	11/01/09	\$0.25	\$1.60
Puerto Rico	6/01/09	\$1.00	\$2.23
Rhode Island	4/10/09	\$1.00	\$3.46
Vermont	7/01/09	\$0.25	\$2.24
Wisconsin	9/01/09	\$0.75	\$2.52

Sources: Tax Burden on Tobacco, Historical Compilation Vol. 47, 2012. Published by Orzechowski and Walker. Campaign for Tobacco Free Kids, Cigarette Tax Rate Increases by State per Year 2000-2013, As of August 1, 2013.

\* Contingency section of 2011 tobacco tax rate decreases specified that if tobacco tax revenues did not increase by July 15, 2013, then the original tobacco tax rates would be restored automatically (without additional legislative action).

† Part of a multi-year series of cigarette tax increases all passed into law at the same time. The rate was increased annually from 2006-2011.

Over the last few years there have been many attempts at legislative changes throughout the country in the way OTP are taxed. The most prevalent is to move little cigars from the OTP category and tax them as cigarettes. Changes in the taxation of moist snuff, a growing market segment, also has been proposed and passed in many states. Currently, regulation and taxation of e-cigarettes is being hotly debated throughout the country. At the time of writing, Minnesota is the only state to tax e-cigarettes as cigarettes.

### Price Elasticity of Demand for Taxable Cigarettes

Price elasticity is a concept used to quantify changes in quantity of demand for a product associated with changes in price. It is defined as the percentage change in quantity demanded in response to a 1 percent change in price. For the last twenty years, estimates have indicated that a 10 percent rise in price reduces the overall cigarette consumption by between 4 and 5 percent (price elasticity of demand of -0.4 to -0.5).<sup>6</sup> However, the hypothesis is that this value increases substantially when states move to having a high tax rate and when they border other states with lower tax rates. What this implies is that the sensitivity of changes in the quantity of taxable cigarettes purchased associated with the changes in the price of cigarettes increases as increased incentives for avoidance or evasion arise. A brief review of the applied literature can be found in Appendix E.

Below are two tables — one identifying the highest 10 state tax rates and the other comparing Minnesota’s tax rate to its surrounding states.<sup>7</sup>

**Table 2-3 States with the Highest Excise Tax Rates (as of July 1, 2013)**

	<b>Tax Rates</b>
<b>1. New York</b>	\$4.35
<b>2. Massachusetts</b>	\$3.51
<b>3. Rhode Island</b>	\$3.50
<b>4. Connecticut</b>	\$3.40
<b>5. Hawaii</b>	\$3.20
<b>6. Washington</b>	\$3.025
<b>7. Minnesota</b>	\$2.83
<b>8. New Jersey</b>	\$2.70
<b>9. Vermont</b>	\$2.62
<b>10. Wisconsin</b>	\$2.52

**Table 2-4 Tax Rates in States Bordering Minnesota**

	Tax Rates	State Ranking (1=highest rate)
1. North Dakota	\$0.44	46 <sup>th</sup>
2. Iowa	\$1.36	26 <sup>th</sup>
3. South Dakota	\$1.53	24 <sup>th</sup>
4. Wisconsin	\$2.52	10 <sup>th</sup>
5. Minnesota	\$2.83	7 <sup>th</sup>

**Are Minnesota’s Fiscal Year 2014 Cigarette Tax Revenue Estimates Reasonable?**

Minnesota’s recent legislation increased the excise tax on cigarettes from \$1.23 to \$2.83 per pack of twenty cigarettes. This represented an increase of \$1.60 per pack. MDOR also imposes an “in lieu” cigarette sales tax determined annually by the department, based on the average price of a pack of cigarettes. This amount was \$0.493 per pack of twenty cigarettes at the time the legislation was enacted. It is scheduled to increase to \$0.512 in January 2014. MDOR’s non-settlement fee increased from 35¢ per pack to 50¢ per pack.<sup>8</sup> The per pack cigarette and “in lieu” sales tax totaled \$3.323 for brands that have a legal settlement with MDOR and \$3.823 for non-settlement brands at the time the legislation was enacted.

The legislation also taxed little cigars as cigarettes. It expanded the definition of cigarettes to include any roll for smoking made wholly or in part of tobacco that weighs 4.5 pounds or less per thousand wrapped in any substance containing tobacco, however labeled or named, which, because of its appearance, size, the type of tobacco used in the filler, or its packaging, pricing, marketing, or labeling, is likely to be offered to or purchased by consumers as a cigarette, unless it is wrapped in whole leaf tobacco and does not have a cellulose acetate or other cigarette-like filter.<sup>9</sup> The primary effect was to tax little cigars as cigarettes.

Experience suggests that, after a tax rate increase, it can take up to six months before new consumption patterns of taxable cigarette and tobacco products normalize.<sup>10</sup> While the first few months of collections under the new law may have fallen short of estimates, based on the above discussion and subsequent analysis JD Michael finds the annual revenue estimate for cigarette and OTP taxes to be reasonable. MDOR used a -0.95 elasticity for taxable cigarettes in estimating revenue associated with the recent cigarette tax increase. This implies that every 10 percent change in the price of cigarettes will lead to a 9.5 percent reduction in taxable consumption. JD Michael evaluated Minnesota’s revenue cigarette tax estimate using two approaches:

- Compare Minnesota’s estimate to Illinois’ recent actual experience.
- Survey other states to gather information on their most recent experience.

## **Case Study: Comparing Minnesota Cigarette Tax Revenue Estimates with Illinois' Recent Experience**

On May 29, 2012, the Illinois General Assembly adopted Senate Bill 2194 raising the taxes on cigarettes from \$0.98 to \$1.98 per pack of twenty. This legislation also changed the definition of cigarettes to include little cigars. This law was signed into law and became effective June 24, 2012. It did not include an effective floor tax.<sup>11</sup>

Since the legislation did not have an effective floor tax, significant hoarding was anticipated. As a result, 46 million stamps over and above what had been assumed in the fiscal year 2012 revenue forecast were sold prior to June 24<sup>th</sup>. Revenue estimates had been on track through May. Using the Illinois experience, while making adjustments for the lack of an effective floor tax, JD Michael compared MDOR's fiscal analysis for House Files 91 (as amended H0091A2). Given that Illinois' receipts were on target to meet the FY2013 forecast through the first eleven months of the fiscal year, it is reasonable to assume the deviation in June is solely attributable to the change in behavior arising from the tax increase. The June data was normalized by subtracting 46 million packs from fiscal year 2012 and adding them into fiscal year 2013 data.

After controlling for behavioral change in anticipation of the tax rate change, Illinois experienced an elasticity of demand for taxable cigarettes of -0.94, compared with Minnesota's estimate of -0.95. In Illinois, for every 10 percent increase in the price of cigarettes associated with the tax increase the quantity of taxable cigarettes decreased by 9.4 percent. What this implies for MDOR is that, if they have the same experience as Illinois, the number of packs of cigarettes sold in fiscal year 2014 in Minnesota will be 159 million. This compares with the Minnesota estimate of 161 million, a statistically insignificant difference. This case study finds Minnesota's cigarette tax estimate for fiscal year 2014 to be consistent with Illinois' actual experience, and suggests that the estimate is very reasonable.

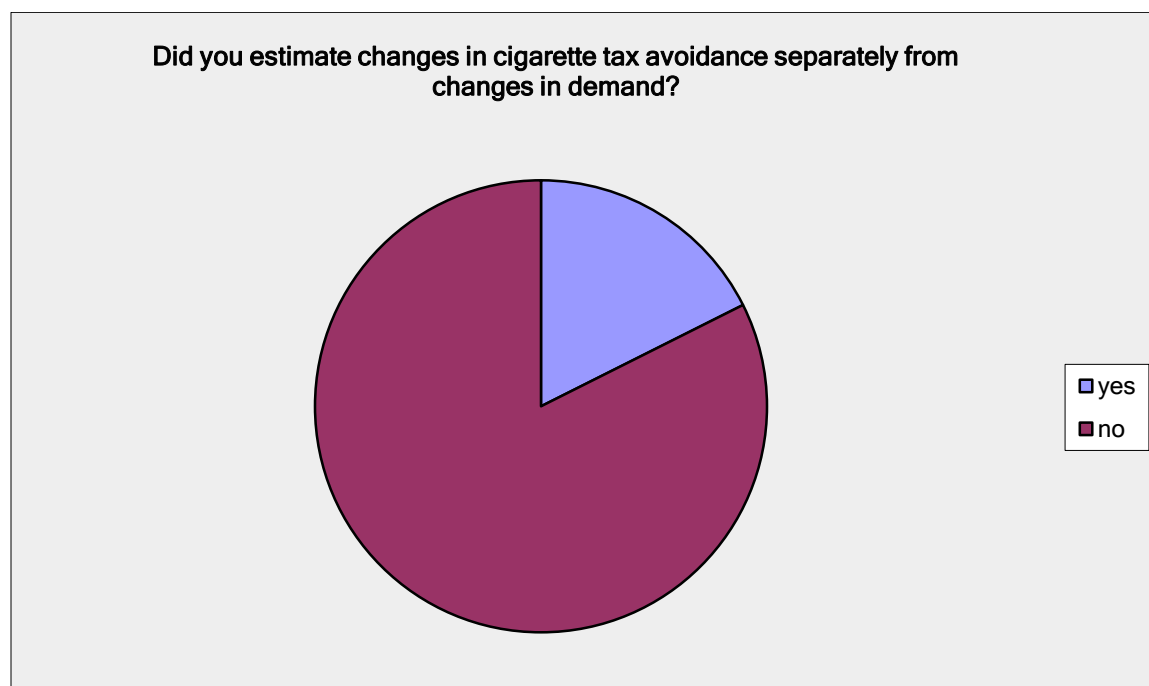
## **Cigarette and Tobacco Products Research Survey**

In order to further address the reasonableness of MDOR's revenue estimate as well as questions about noncompliance rates by product type and the effectiveness of stamping, a survey was designed and sent to 46 state revenue research offices.<sup>12</sup> Nineteen responses were received. What follows is a summary of survey results that can shed light on revenue estimating associated with tax increases, whether or not the product is stamped, and estimates of noncompliance rates by product. This survey was administered during the first two weeks of November, 2013.

## Cigarette Revenue Estimation

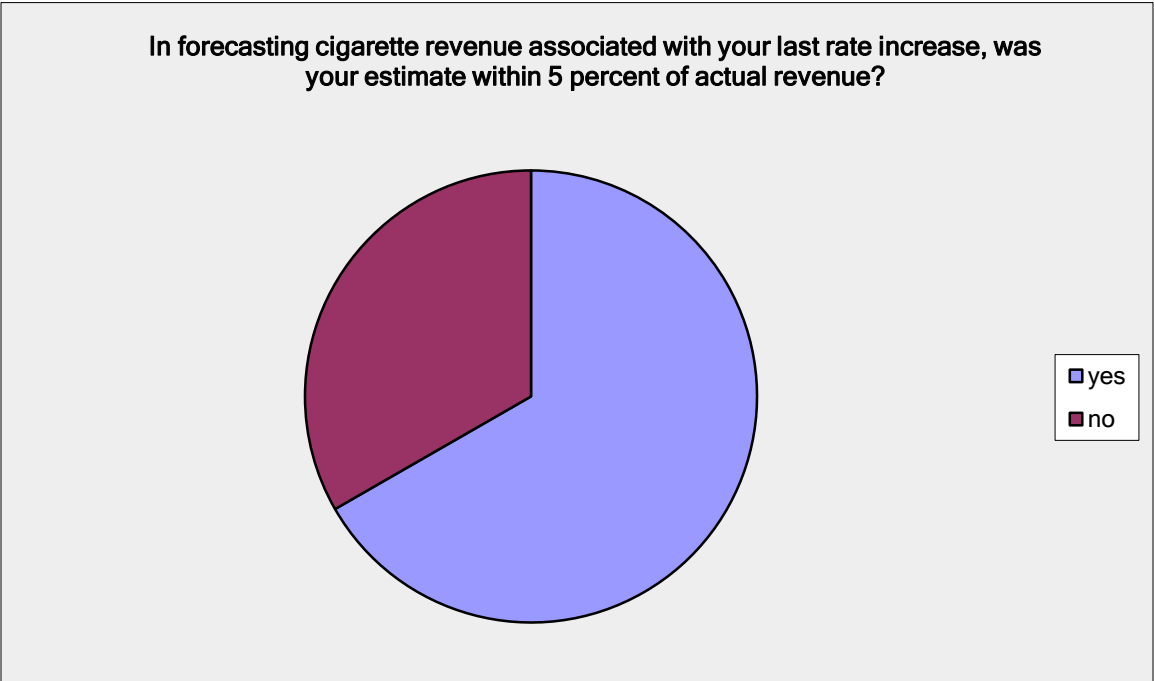
The survey asked states if when they were making revenue estimates, they estimated changes in cigarette tax avoidance separately from changes in demand. This question was developed in order to understand what level of data states had available to help them refine estimates associated with increasing tax rates. In Minnesota, tax avoidance was not calculated separately from changes in demand. This was the case in over 80 percent of the responding states. Three out of seventeen responding states indicated that they did estimate these impacts separately. Two of the states used judgment based on rates in surrounding states to break out an estimate for increased avoidance, while one worked closely with faculty from a local university.

**Chart 2-1 Survey Results of Estimates Associated with Tax Avoidance with Tax Increases for Cigarettes**



JD Michael then asked states to identify what price elasticity for taxable cigarette demand they used in estimating revenue associated with their most recent cigarette tax increase. The values JD Michael received varied from -0.4 to -1.45. In order to understand this variation JD Michael then looked at whether tax rates appeared to be correlated with elasticities. The results lend credence to the hypothesis that elasticities increase as the tax rate goes above approximately \$2 per pack of twenty cigarettes.<sup>13</sup> This impact is exacerbated if the state borders a low tax state.<sup>14</sup> MDOR's estimate is based on an elasticity value associated with high-tax rate states and states that border low-tax states.

**Chart 2-2 Survey Results of Estimates in Revenue Associated with Tax Increases**



In estimating revenue associated with a tax rate increase, survey results indicate that for two thirds of the responding states, revenues came in within 5 percent of the estimate. For states with high tax rates and who used an elasticity estimate that was in the same range as Minnesota this increased to 100 percent. This gives additional confidence that MDOR’s cigarette tax estimate for fiscal year 2014 will be reached.

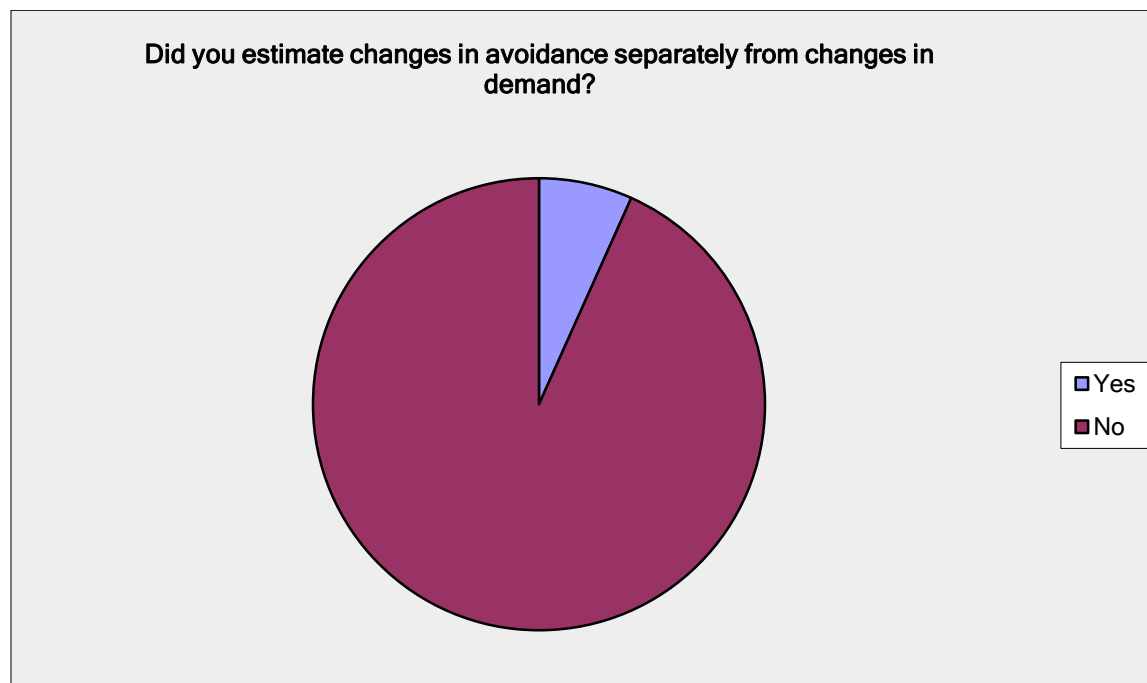
**Other Tobacco Products Revenue Estimation**

Minnesota’s recent legislation repealed the 35 percent OTP health impact fee, while increasing the OTP excise tax of 35 percent of the wholesale price to 95 percent of the wholesale price. This represents a 25 percent change in the tax rate. The legislation also created a minimum tax for each container of moist snuff equal to the rate imposed on a pack of cigarettes.<sup>15</sup>

A set of survey questions was developed in order to assess MDOR’s OTP revenue estimate and address issues of noncompliance and stamping associated with these products.



**Chart 2-3 Survey Results of Estimates Associated with Tax Avoidance with Tax Increases for Other Tobacco Products**



The majority of states (14 out of 15) including Minnesota, did not estimate changes in avoidance separately from changes in demand when they had their most recent OTP tax changes. The one state that estimated avoidance separately from changes in demand worked with faculty at a local university to do so.

The elasticity used for estimating the impact of tax changes associated with OTP ranged from -0.2 to -0.6, with a mean of -0.5, considerably lower than the range associated with cigarettes. MDOR used an elasticity of -0.6, a conservative measure for budgetary purposes.

To determine the reliability of measures of responsiveness to changes in demand identified above, the survey question was "In forecasting OTP revenue associated with your last rate increase, was the estimate within 5 percent of actual revenue? "

Survey results indicate that 66.7 percent of responding states (6 out of 9) had a variance of 5 percent or more in actual OTP tax revenue compared with their estimate associated with the most recent tax change compared with cigarette tax revenue. Given this experience, MDOR's decision to use an elasticity measure at the high end of the range seems prudent.

JD Michael concluded from available information and survey results that MDOR's estimate for additional cigarette tax arising from the recent tax increase is consistent with what high tax states' have recently experienced. In the case of OTP, there appears to be evidence that states have a more difficult time estimating the revenue impact of changes in the tax rate for OTP. Minnesota's estimate is conservative, but given the uncertainty in forecasting OTP experienced

in other states, the MDOR staff should continue to monitor fiscal year 2014 OTP tax receipts carefully.

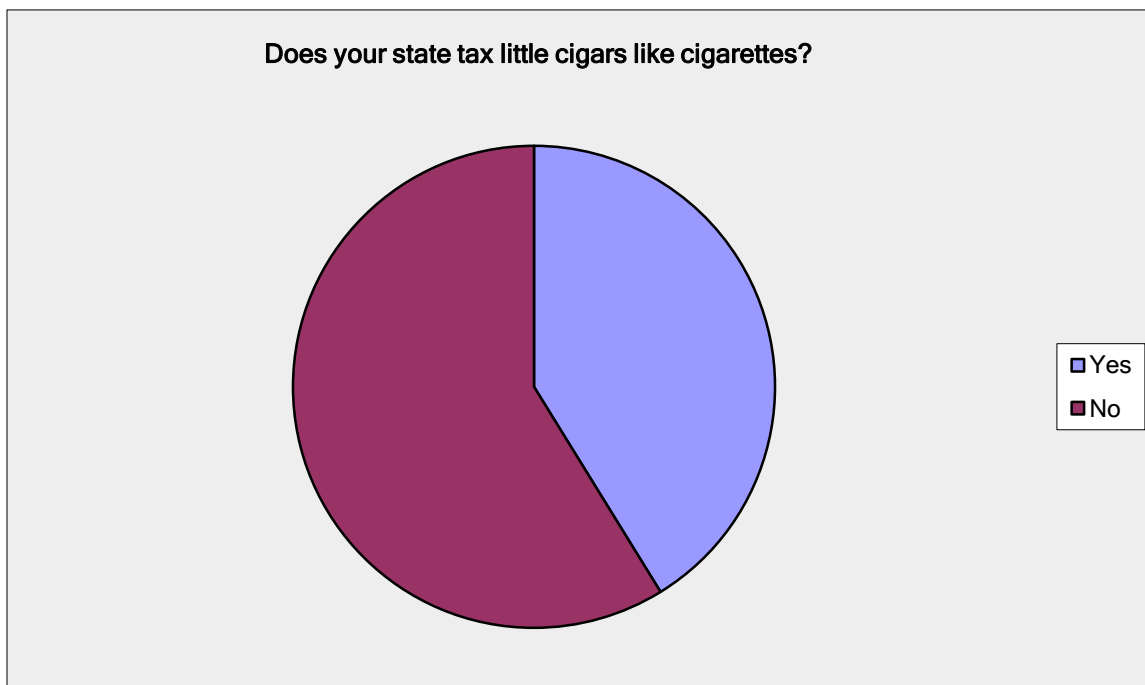
The Minnesota legislature asked for the following information:

- Rates of noncompliance by product
- Assessment of the effectiveness of stamping OTP

Data is not available to definitively address either of these issues, either in Minnesota or any other state. One major impediment is that there does not appear to be one definitive source of hard data for total cigarette and tobacco consumption (legal and illicit) used by researchers, and as such, the volume of illicit product can only be estimated.<sup>16</sup> Having said this, some applied research on this issue has been conducted in several states (see Appendix E).

Several of the survey questions were designed specifically to attempt to provide information on noncompliance rates and the effectiveness of stamping.

**Chart 2-4 Survey Results of States that Tax Little Cigars Like Cigarettes**



One recent trend in taxation has been for states to start taxing little cigars as cigarettes, to reduce the incentive to substitute little cigars for cigarettes. Survey results show that this is true for over 40 percent of the responding states. Minnesota falls into this category.

The survey then moved toward asking questions about OTP.

**Table 2-5 Surveyed States' Stamping Information on OTP**

<b>Does your state stamp any of the following tobacco products?</b>			
<b>Answer Options</b>	<b>Yes</b>	<b>No</b>	<b>Response Count</b>
Little cigars	4	12	16
Large cigars and cigarillos	0	15	15
Premium cigars	0	15	15
Loose cigarette tobacco (roll your own)	0	15	15
Loose dual purpose tobacco	0	15	15
Pipe and hookah tobacco	0	15	15
Moist Snuff/dip tobacco	0	15	15
Dry snuff	0	15	15
Chewing tobacco	0	15	15
Snus	0	14	14
e-cigarettes	0	13	13

Stamping is one component of a comprehensive enforcement strategy. Minnesota requires that stamps be placed on cigarettes and little cigars. Going forward, Minnesota could investigate requiring the stamping of remaining OTP.

As indicated above, hard data on overall noncompliance is not available, either in Minnesota or in other states. As an alternative approach, JD Michael asked states to estimate noncompliance rates by product type. JD Michael found that cigarettes have the highest compliance rate; however only 44.4 percent of the responding states indicated a cigarette compliance rate of 95 percent or more. This increases to 77.7 percent at the 90 percent or more range. Minnesota's estimated compliance rate is average of states surveyed.

For OTP, estimated compliance falls off significantly. Half of the reporting states indicate that noncompliance for all types of cigars, loose and dual purpose tobacco, and pipe tobacco is greater than 10 percent. Compared with the state average, MDOR's estimated compliance rates are average or above average for all product other than large cigars and cigarillos and premium cigars.

**Table 2-6 Surveved States' Noncompliance Rates on Other Tobacco Products**

<b>Noncompliance Rates</b>	<b>&lt; 5%</b>	<b>5-10%</b>	<b>10-20%</b>	<b>20-30%</b>	<b>30-40%</b>	<b>Response Count</b>
Cigarettes	4	3	1	0	1	9
Little cigars	3	1	2	1	1	8
Large cigars and cigarillos	2	2	2	1	1	8
Premium cigars	3	1	2	1	1	8
Loose cigarette tobacco	2	2	2	1	1	8
Loose dual purpose tobacco	2	2	2	1	1	8
Pipe and hookah tobacco	2	2	2	1	1	8
Moist Snuff/dip tobacco	3	2	1	1	1	9
Dry snuff	3	2	1	1	1	8
Chewing tobacco	3	2	1	1	1	8
Snus	2	2	1	1	1	7

The above research and analysis finds that MDOR's revenue estimates are solid. However, given other states' experience after increasing OTP taxes, MDOR should continue to pay close attention to monthly receipts. In addition, MDOR's estimated compliance rates are either average or above average for products other than cigars.

# Section 3

## Compliance and Enforcement Methods

This section of the report examines collection and enforcement methods in selected states. States included in this survey research were identified and included because either they were surrounding states or states identified by subject matter experts as having some innovative cigarette and other tax products (OTP) tax practices. Results are presented and analyzed in aggregate and are based on information received from the survey administered to the selected states during the month of November and compares practices with those in Minnesota.<sup>17</sup> Results are reported in aggregate as survey participants were instructed that state-specific information would not be disclosed.

Overall observations from the survey results lead us to conclude that Minnesota has reached a crossroads. Minnesota has recently become a high tax state and with that will come increased noncompliance. States that were surveyed fall into two major categories – those that have relatively low tax rates and are focused on collections and audit activities versus higher tax states that border low tax states. These higher tax states appear on average to place a greater emphasis on

- licensing all stages in the supply chain,
- conducting unscheduled inspections at all levels of the supply chain,
- increasing both civil and criminal fines and penalties, and
- additional data-matching and capture compared with low-tax states.

The survey questions were developed by subject matter experts from MDOR and the project team. The questions are based on issues or ideas that have been or are currently being discussed in national groups, such as the Federation of Tax Administrators Tobacco Tax group or in the relevant literature (see Appendix F for an overview of major issues and Appendix G for a copy of the survey instrument). The survey was designed to address issues falling under the following headings:

- Background information
- Department budget information
- Cigarette specific questions
- OTP specific questions
- Front-end administration compliance initiatives
- Assessment
- Audit
- Compliance and enforcement inspections and activity
- Concluding questions

## **Background and Budget**

Results indicate that salary ranges in the responding states are comparable to those in Minnesota. In terms of staff allocated to cigarette and OTP tax compliance and enforcement, it is difficult to draw clear conclusions as only four states answered this question. However, based on the limited data received, Minnesota falls on the mid-to-lower end of the spectrum. Responding states that fall into this category are low tax states. Minnesota is not considered a low tax state.

Responding states do not have revenue generated from enforcement activities deposited directly into a separate enforcement fund; the enforcement budget appears to come out of the general department budget allocation. However, based on survey results, it appears that there may be an opportunity to work with the industry to help defray some of the additional costs that would result from any increased enforcement efforts.

## **Licensing and Stamping**

Questions for licensing and stamping were developed because it is widely believed that licensing and stamping product increases compliance. License fee information was obtained from state statutes. See Appendix H for the statutory fees for the states that were selected. The remaining information came from the survey. The first observation is that, unlike 7 of the survey states, Minnesota does not license retailers at the state level. This has several ramifications. First, it makes it difficult to implement a floor tax on retailers when the tax rate changes since there is not a comprehensive data source for licensed retailers in Minnesota. Second, not having a state-level retailer's license reduces the state's enforcement efforts when a retailer is found to be in violation of the cigarette and OTP tax laws. For example, a strategy employed by two of the responding states is to revoke the retailer license and lottery license if the retailer is found to be in violation of the statute. Retail license fees for cigarettes ranged from a one-time fee of \$100 to a \$300 annual fee. Similar licenses and associated fees generally apply for OTP.

## **Cigarette**

In terms of licensing, Minnesota charges a licensing fee for two of the four major categories identified below. For the two categories where fees are charged, distributors and sub-jobbers, Minnesota's fee levels are significantly below the survey average. In five of the responding states, the license fee for distributors and sub-jobbers (known as wholesalers in some states) is equal. While sub-jobbers do not stamp products, they do distribute and a case can be made for treating them in a manner similar to distributors. This would include inspecting sub-jobbers with the same frequency as distributors.

<b>Cigarette Licenses and Associated Fees</b>	<b>MN</b>	<b>Survey States with License Fees</b>	<b>Minnesota Fee (annualized)</b>	<b>Average State Fee (annualized)</b>
<b>Retailers</b>	No	7	N/A	\$99
<b>Sub-jobbers</b>	Yes	8	12	\$434
<b>Vending Machines</b>	No	6	N/A	Varies based on number of machines
<b>Distributor</b>	Yes	11	150	\$323
<b>Manufacturer</b>	No	3	N/A	\$0 to fee assessed on market share

With regard to other cigarette licensing practices, Minnesota meets five of the eight practices identified below.

<b>Additional Cigarette Licensing Requirements</b>	<b>MN</b>	<b>States Answering Yes</b>
<b>Manufacturers are required to hold a license if they ship to distributors or sub jobbers.</b>	No	5
<b>Distributors are required to hold a license if they ship to other distributors in the state.</b>	Yes	6
<b>Distributors are required to hold a license if they ship to in-state retailers.</b>	Yes	8
<b>Does the state issue transporter permits to transport cigarettes through the state?</b>	No	3
<b>Does the state deny a license if the owner owes other states taxes?</b>	Yes	5
<b>Does the state deny a license if the owner has any type of felony conviction?</b>	Yes	5
<b>Does the state deny a license if the owner owes any other state debt?</b>	Yes	2
<b>A bond required as part of the licensing requirements?</b>	No	6

Based on the above results, Minnesota should review its current licensing practices, and consider introducing some new licenses for retailers, vending machines, and manufacturers, as well as adjusting fees associated with current licenses. Any additional revenue arising from this review and subsequent recommendations could be used to help defray the cost of increased inspections, particularly unscheduled inspections of distributors, sub-jobbers, and

manufacturers. Minnesota could also consider requiring a bond as part of the licensing requirement.

<b>Cigarette Stamping Questions</b>	<b>MN</b>	<b>States Answering Yes</b>
<b>Is payment for stamps due at the time of purchase?</b>	No	7
<b>What percentage of payments is made electronically?</b>	95%	91%
<b>Is the stamp changed when there is a tax rate change?</b>	No	5
<b>Does the state refuse to sell stamps to a licensee who is default or has violated the cigarette statute?</b>	Yes	8
<b>When a claim for credit or refund is filed:</b>		
<ul style="list-style-type: none"> <li>• <b>are distributors required to return damaged stamps?</b></li> </ul>	No	8
<ul style="list-style-type: none"> <li>• <b>are manufacturers required to file affidavits ?</b></li> </ul>	Yes	8
<ul style="list-style-type: none"> <li>• <b>is the account automatically referred to audit?</b></li> </ul>	No	4

Several states mandate electronic payments for stamp purchases. Minnesota mandates electronic payments if the amount owed during a fiscal year is \$10,000 or more. In addition, in their first year of operation, businesses have to pay with secured funds. The percent of payments received electronically is 95 percent, suggesting that a complete mandate is not needed at this time. The majority of states either require payment up front or require a bond if the payment is made after delivery. Minnesota could consider adopting these practices to avoid the risk of default.<sup>18</sup> Minnesota is the only responding state that, when a claim for credit or refund is filed, does not require distributors to submit or return damaged stamps in all circumstances. In addition, Minnesota is one of the few respondents that do not automatically refer such an account to audit.

All states, with the exception of Minnesota and one other responding state, indicated that they change their stamp when they have a tax rate change. This did not occur in Minnesota with the recent tax increase and as such is likely to have encouraged higher noncompliance than would have occurred had there been a stamp change.



## Other Tobacco Products

Minnesota licenses two of the three categories in the OTP distribution chain. As is the case with cigarettes, Minnesota's fees are significantly below the survey state average.

Other Tobacco Products Licensing and Associated Fees	MN	States Answering Yes	Minnesota Fee (annualized)	Average State Fee (annualized)
Retailers	No	6	N/A	\$93
Sub-jobbers	Yes	5	10	\$283
Distributor	Yes	7	37.5	\$328
Manufacturer	No	4	N/A	\$1,050

Several survey states require out-of-state OTP manufacturers to hold a license in the state if they ship to distributors or sub-jobbers in the state. In addition, they require distributors to hold a license if they ship to other distributors or retailers in the state. While Minnesota requires these licenses for cigarettes, the state does not require them for OTP. Minnesota should consider aligning licensing requirements for cigarettes and OTP products.

Additional Other Tobacco Products Licensing Questions	MN	States Answering Yes
Manufacturers are required to hold a license if they ship to distributors or sub-jobbers	No	3
Distributors are required to hold a license if they ship to other distributors in the state	No	4
Distributors are required to hold a license if they ship to in-state retailers	No	7
State issues transporter permits to transport tobacco products through the state	No	3
State denies a license if the owner owes other states taxes	Yes	5
State denies a license if the owner has any type of felony conviction	Yes	3
State denies a license if the owner owes any other state debt	Yes	1
A bond required as part of the licensing requirements	No	4

When it comes to stamping, Minnesota's recent legislation requires little cigars to be stamped and taxed like cigarettes. Expanding stamping to other products would need the support of the

distributor and possibly the manufacturing communities. Such a significant issue may be best addressed at the national level.

What, if any, other tobacco products are required to have a stamp affixed?	MN	States Answering Yes
Little cigars	Yes	2
Other	No	0

## Compliance and Enforcement Efforts

In terms of front-end initiatives, all responding states indicated that they cross-check cigarette and OTP shipment information received from manufacturers with distributor purchases as well as share information with other states. The type of information shared includes cross border shipments of both cigarette and tobacco products. However, the process used to share information does not appear to be systematic or efficient. Some states share upon request, while others share information on a regular monthly basis. Minnesota could consider entering into information-sharing agreements with other states that would provide for monthly reports received electronically.

In and of themselves, licensing and stamping are necessary but not sufficient actions in combating non-compliance. Such efforts need to go hand-in-hand with inspections, particularly unscheduled inspections, at all levels of the supply chain.

There is great variety in how and what kind of inspections are carried out among responding states. These include – the ratio of scheduled to unscheduled inspections; whether or not they are conducted by a criminal investigator; and whether or not the criminal investigator is a sworn officer. For example, results indicate that scheduled inspections as a percent of total inspections ranged from less than 1 percent to approximately 50 percent. In the survey states, someone other than a criminal investigator is more likely to conduct scheduled inspections. However, there is some modest evidence that unscheduled inspections are more likely conducted by a criminal investigator. Unscheduled inspections are usually conducted by someone who is driving an unmarked vehicle. Minnesota’s inspections are predominantly unscheduled and carried out primarily by someone who is not a criminal investigator who is driving a marked car. Some inspections are carried out by a criminal investigator who drives an unmarked vehicle.

Only two survey states use digital stamps and/or barcodes. States that have not moved to this higher technology product claimed that the associated costs are prohibitive and that the technology has not proven to be substantially more effective than less costly alternatives. However, California claims that implementing a comprehensive strategy that included switching to a technology-based stamp resulted in a combined annual increase in revenue (sales and excise taxes) of almost \$150 million.<sup>19</sup> While the results are not definitive, in part because they do not factor in the cost associated with implementing the new stamp, they do suggest that in

light of the recent tax increases and associated increase in noncompliance that Minnesota could fully examine the cost-benefit of adopting a higher technology stamp.

When it comes to criminal prosecution, MDOR has only one criminal investigator and prosecutes significantly fewer cases annually compared with the 3 other survey respondents who answered related survey questions. For the responding states, the vast majority of cases resulted in the defendant receiving a misdemeanor and fine; jail time appears to be a rare outcome.

The survey asked one final overarching question.

In your opinion, how do the following factors rank in terms of increasing compliance? (1=most important, 10 least important)	MN	States (Average Ranking)
a. Stamping product	1	1
b. Budget resources for audit	3	3
c. Budget resources for collections	8	9
d. Budget resources for investigations	2	2
e. New computer systems	6	8
f. Increased data capture	5	5
g. Data matching	7	4
h. Changes in civil fines and penalties	9	7
i. Changes in criminal fines and penalties	4	6
j. Other – please specify: State-level licensing of retailers		

The top three most important factors identified by Minnesota and the other survey states were identical – stamping product, budget resources for investigations, and budget resources for audit. The MDOR staff identifies changes to criminal fines and penalties to be the next most critical factor for increasing compliance, followed by data capture and new computer systems.

### Arrangements with Tribal Nations across States

Many tribes and states are discovering ways to set aside jurisdictional debate in favor of cooperative government-to-government relationships that respect the autonomy of both governments. It is now common for tribes and states to work together to build new structures for communication and cooperation.<sup>20</sup> Eight of the selected survey states contain Native American territories. State-level treatment of cigarette and OTP purchased on Native American territories differs throughout the states (see Appendix I for state-level details). Many of the states have adopted official agreements/compacts between the state and the tribes as the preferred method of collaboration. While the terms of the agreements differ across the states, results suggest that this close cooperation between the state government and the tribe minimizes tax evasion by non-tribal member purchasers. Minnesota has entered into agreements with all but one tribe. The state collects all state and tribal taxes covered by the

agreement and make payments to the tribal government from the funds collected. The tax agreements do not have expiration dates and either party can seek to amend or cancel it. The agreements allow MDOR to seek tribal government assistance with collecting debts and auditing. Tribes receive 100 percent refund for the tax paid by tribal members and fifty percent refund for taxes paid by non-tribal members. Such “revenue sharing” agreements have a positive impact on compliance.

## **Options for Consideration**

Based on the above analysis, the following options are offered:

- License retailers at the state level.
- Adjust license fees. In many instances, MDOR fees are below the average of the states surveyed.
- Treat cigarette and tobacco products sub-jobbers as distributors in terms of licensing and reporting.
- License all stages of the supply and distribution chain, from manufacturers to retailers, for both cigarette and tobacco products.
- Evaluate stamping tobacco products that do not currently require a stamp.
- Increase resources to allow for regular scheduled and unscheduled inspections at all levels of the supply and distribution chain (from manufacturers to retailers).
- Conduct detailed cost-benefit analysis of introducing a high-technology stamp.
- Increase the resources allocated to criminal investigations.
- Increase civil and criminal fines and penalties. These are discussed further in Section 4 and Appendix J of the report.

# Section 4

## Fines, Penalties, Criminal Charges, Interest, and Sanctions

This section of the report presents a summary of the Minnesota Department of Revenue's current fines and penalties and compares them with statutory fines and penalties in the selected states. Below is a summary of MDOR's current practice. Appendix J contains detailed information by type of fine and penalty for all survey states compared to Minnesota.

### Minnesota's Monetary Penalties

#### ***Penalty for Failure to Pay Tax***

If the tax imposed is not paid within the time specified for payment, a penalty is added to the amount required to be shown as tax. The penalty is 5 percent of the tax not paid on or before the date specified for payment of the tax if the failure is for not more than 30 days, with an additional penalty of 5 percent of the amount of tax remaining unpaid during each additional 30 days or fraction of 30 days during which the failure continues, not exceeding 15 percent in the aggregate. This penalty is typically referred to as a late payment penalty.

#### ***Penalty for Failure to Make and File Return***

If a taxpayer fails to make and file a return within the time prescribed, including an extension, a penalty of 5 percent of the amount of tax not timely paid is added to the tax. This penalty is typically referred to as a late filing penalty. The maximum penalty for paying and filing late is 20 percent. If the filer knowingly files a false or fraudulent return, or intentionally does not file to avoid paying tax, criminal penalties may also apply.

#### ***Penalty for Intentional Disregard of Law or Rules***

If part of an additional assessment is due to negligence or intentional disregard of the provisions of the applicable tax laws or rules of the commissioner, but without intent to defraud, there will also be an amount equal to 10 percent of the additional assessment added to the tax.

#### ***Penalty for Repeated Failures to File Returns or Pay Taxes***

If there is a pattern by a person of repeated failures to timely file returns or timely pay taxes, and written notice is given that a penalty will be imposed if such failures continue, a penalty of 25 percent of the amount of the tax not timely paid as a result of each such subsequent failure is added to the tax.

### ***Penalty for False or Fraudulent Return or Evasion***

If a person files a false or fraudulent return, or attempts in any manner to evade or defeat a tax or payment of tax, there is imposed on the person a penalty equal to 50 percent of the tax due for the period to which the return is related, less amounts paid by the person on the basis of the false or fraudulent return.

## **Reasons for Possible Criminal Charges in Minnesota**

### ***Penalties for Failure to File or Pay***

- 1) A person or consumer required to file a return, report, or other document with the commissioner who fails to do so is guilty of a misdemeanor.
- 2) A person or consumer required to pay or to collect and remit a tax, who fails to do so when required, is guilty of a misdemeanor.

### ***Penalties for Knowingly Failing to File or Pay***

- 1) A person or consumer required to file a return, report, or other document with the commissioner, who knowingly, rather than accidentally, inadvertently, or negligently, fails to file it when required, is guilty of a gross misdemeanor.
- 2) A person or consumer required to pay or to collect and remit a tax, who knowingly, rather than accidentally, inadvertently or negligently fails to file it when required, is guilty of a gross misdemeanor.

### ***False or Fraudulent Returns***

- 1) A person or consumer who files with the commissioner a return, report, or other document, or who maintains or provides invoices subject to review by the commissioner, known by the person or consumer to be fraudulent or false concerning a material matter, is guilty of a felony.
- 2) A person or consumer who knowingly aids or assists in, or advises in the preparation or presentation of a return, report, invoice, or other document that is fraudulent or false concerning a material matter, whether or not the falsity or fraud is committed with the knowledge or consent of the person or consumer authorized or required to present the return, report, invoice, or other document, is guilty of a felony.

### ***Counterfeiting***

Any person who makes, alters, forges, or counterfeits a stamp, or who possesses an altered, forged, or counterfeit stamp is guilty of a felony.

### ***Unstamped Cigarettes/Untaxed Tobacco Products***

- 1) A person, other than a licensed distributor or a consumer, who possesses, receives, or transports fewer than 5,000 unstamped cigarettes, or up to \$350 worth of untaxed tobacco products is guilty of a misdemeanor.
- 2) A person, other than a licensed distributor or a consumer, who possesses, receives, or transports 5,000 or more, but fewer than 20,001 unstamped cigarettes, or more than \$350 but less than \$1,400 worth of untaxed tobacco products is guilty of a gross misdemeanor.
- 3) A person, other than a licensed distributor or a consumer, who possesses, receives, or transports more than 20,000 unstamped cigarettes, or \$1,400 or more worth of untaxed tobacco products is guilty of a felony.
- 4) An individual in possession of more than 4,999 unstamped cigarettes, or more than \$350 worth of untaxed tobacco products, is presumed not to be a consumer.

### ***Sale of Cigarette Packages with Indian Stamp***

- 1) A retailer doing business off of an Indian reservation who sells or offers to sell more than 200 but fewer than 5,000 cigarettes with Indian stamps is guilty of a misdemeanor.
- 2) A retailer doing business off of an Indian reservation who sells or offers to sell 5,000 or more, but fewer than 20,001 cigarettes with Indian stamps is guilty of a gross misdemeanor.
- 3) A retailer doing business off of an Indian reservation who sells or offers to sell more than 20,000 cigarettes with Indian stamps is guilty of a felony.

### ***Sales after License Revocation***

A person selling cigarettes or tobacco products after the person's license has been revoked is guilty of a felony.

### ***Purchases from Unlicensed Sellers***

No retailer or sub-jobber shall purchase cigarettes or tobacco products from any person who is not licensed as a licensed distributor or sub-jobber.

- 1) A retailer or sub-jobber who purchases from an unlicensed seller fewer than 5,000 cigarettes or up to \$350 worth of tobacco products is guilty of a misdemeanor.
- 2) A retailer or sub-jobber who purchases from an unlicensed seller 5,000 or more, but fewer than 20,001 cigarettes or more than \$350 but less than \$1,400 worth of tobacco products is guilty of a gross misdemeanor.
- 3) A retailer or sub-jobber who purchases from an unlicensed seller more than 20,000 cigarettes or \$1,400 or more worth of tobacco products is guilty of a felony.

During the review of the survey-states' statutes JD Michael noticed that some states' penalties, criminal charges, or sanctions stood out in terms of severity. These examples are highlighted in this section to provide a context for MDOR's own fine and penalty structure. See Appendix J for a full listing.

## **Examples of Monetary Penalties in Selected Survey States**

These are penalties that may be imposed by taxing departments without the need for prosecution in a court of law. Please note that the language used in these examples is summary rather than a direct quote of the law.

### ***Failure to Pay Tax***

Generally, this penalty is imposed if the tax is not paid within the time specified for payment. The penalty is added to the amount required to be shown as tax. This penalty is typically referred to as a late payment penalty.

**New York:** 50 percent of the amount of tax due plus 1 percent of the amount for each month [New York Code, Article 20 § 481(B)].

### ***Failure to Make and File Return***

Generally, this penalty is imposed if a taxpayer fails to make and file a return within the time prescribed, including an extension. A penalty of a certain percent of the amount of tax not timely paid is added to the tax. This penalty is typically referred to as a late filing penalty.

**New York:** 10 percent of tax due plus 1 percent for each month up to 30 percent. [New York Code, Article 20 § 481(1) (a) (i) (A)]. If the return is not filed within 60 days of the due date for filing, the penalty imposed is the lesser of \$100 or 100 percent of the amount required to be shown as tax on the return [New York Code, Article 20 § 481(1)(a)(i)(C)].

### ***Negligence or Intentional Disregard of Law or Rules***

Generally, this penalty is assessed if part of an additional assessment is due to negligence or intentional disregard of the provisions of the applicable tax laws or rules, but without intent to defraud.

**Wisconsin:** 25 percent of the tax if there was negligence in filing a return [Wis. Stat. 139.44(12) (Cigarette)], [Wis. Stat. 139.85(1) (Tobacco)].



### ***False or Fraudulent Return; Evasion***

Generally, if a person files a false or fraudulent return, or attempts in any manner to evade or defeat a tax or payment of tax, there is imposed on the person a penalty equal to a percent of the tax due for the period to which the return related, less amounts paid by the person on the basis of the false or fraudulent return.

**New York:** Penalty of two times the amount of tax due, plus (B) interest on such unpaid tax [New York Code § 481(iv) (A)].

### ***Untaxed Cigarettes or Other Tobacco Products***

Generally, this is a use tax penalty that is imposed for bringing unstamped product into a state but it can be imposed on untaxed cigarettes that are acquired within the state or on counterfeit cigarettes.

**New Jersey:** Possession of untaxed cigarettes, failure to remit tax due, \$250 penalty per carton (civil offense).<sup>21</sup> Not more than \$1,000 for each individual carton of unstamped or illegally stamped cigarettes in the dealer's possession, which penalty shall be sued for and recovered [N.J. Rev.Stat. 54:40A-25 (602)].

### ***Operating Without a License***

Operating without a license can include someone who has never received a license, or someone who is operating on a revoked or suspended license.

**New York:** Retailers: first violation, \$5,000 - \$25,000, second or subsequent within three years, \$10,000 - \$35,000 [New York Code, Article 20 § 480-3a].

Owners and operators of vending machines through which cigarettes or tobacco products are sold: first violation \$750 - \$2,000, second or subsequent within three years, \$2,000 - \$6,000 [New York Code, Article 20 § 480-3b].

## Examples of Criminal Charges and Penalties in Selected Survey States

Criminal penalties are penalties that can be imposed when prosecuted in a court of law that can involve fines and jail time.

### ***Failure to File or Pay***

This is a criminal penalty that is generally imposed if a taxpayer fails to make and file a return and pay within the time prescribed, including an extension.

**Illinois:** When the tobacco products tax amount due is under \$300, any distributor who fails to file a return is guilty of a Class 4 felony. When the tobacco products tax amount due is over \$300, any distributor who fails to file a return is guilty of a Class 3 felony [Illinois 35 ILCS 143/10-50 (Tobacco Products Tax)].

### ***Knowingly Failure to File or Pay***

This is a criminal penalty that is generally imposed if a taxpayer knowingly, rather than accidentally, inadvertently, or negligently, fails to file a return or pay the tax when required within the time prescribed, including an extension. Some states call this a penalty for evasion.

**Illinois:** Class 4 Felony [Illinois 35 ILCS 130/25 (Cigarette)].

Class 4 felony when the tobacco products tax amount due is under \$300.  
Class 3 felony when the tobacco products tax amount due is over \$300,  
[Illinois 35 ILCS 143/10-50 (Tobacco)].

### ***False or Fraudulent Returns***

This is a criminal penalty that is generally imposed if a person or consumer files a return, report, or other document; or maintains or provides invoices subject to review, and the material matter is known by the person or consumer to be fraudulent or false.

#### **Minnesota:**

- Filing a return, report, or other document, or maintaining or providing invoices subject to review, known by the person or consumer to be fraudulent or false concerning a material matter, is a felony (imprisonment for not more than 5 years or payment of a fine of not more than \$10,000, or both [Minn. Stat. 609.03]).
- Knowingly aiding or assisting in, or advises in the preparation or presentation of a return, report, invoice, or other document that is fraudulent or false concerning a material matter, whether or not the falsity

or fraud is committed with the knowledge or consent of the person or consumer authorized or required to present the return, report, invoice, or other document, is a felony (imprisonment for not more than five years or payment of a fine of not more than \$10,000, or both [Minn. Stat. 609.03]). [Minn. Stat. 297F.20 sub 3].

### ***Failure to Keep Records***

This is a criminal penalty that is generally imposed when a business fails to keep proper books, records, or invoices.

**Illinois:** Class 4 felony and may be fined up to \$5,000 [Illinois 35 ILCS 130/14 and Illinois 35 ILCS 130/15 (Cigarette)].

Class A misdemeanor and may be fined up to \$1,000 [Illinois 35 ILCS 135/22 and Illinois 35 ILCS 135/23 (Cigarette Use)].

Class 4 felony. A person commits a separate offense for each day engaged in business [Illinois 35 ILCS 143/10-50 (Tobacco Products Tax)].

### ***Counterfeit Stamps***

This is a criminal penalty that is generally imposed if a person makes, alters, forges, or counterfeits a stamp, or is in possession of an altered, forged, or counterfeit stamp.

**New York:** Class E felony, 1-4 years imprisonment, fine \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense [New York Pen. §70.00(e) and § 80.00 and §80.10] [New York Code, Article 37 § 1814 (g)].

### ***Counterfeit Cigarettes/Papers or Gray Market Cigarettes/Papers***

**Virginia:** Gray market cigarettes - possesses, acquires, transports, or offering to sell or failure to report imported cigarettes, is guilty of a Class 5 felony [Code of Virginia § 58.1-1036.], 1-10 years imprisonment, or in the discretion of the jury or the court trying the case without a jury, confinement in jail for not more than 12 months and a fine of not more than \$2,500, either or both [Code of Virginia, Title 18.2 § 18.2-10(e)].

### ***Unstamped Cigarettes; Untaxed Tobacco Products; Contraband***

This is a criminal penalty that is generally imposed on person (other than someone authorized) for possessing, receiving, transporting unstamped cigarettes or untaxed tobacco or products deemed to be contraband. However, it can apply to license holders. This penalty is usually tiered in severity depending on the volume the person possesses, receives, or transports. Many statutes will state that an individual in possession of a certain amount is presumed not to be a consumer.

#### **Michigan:**

- A felony and a fine of not more than \$5,000 or imprisonment for not more than 5 years, or both, when a manufacturer's representative sells, exchanges, or disposes of cigarettes or tobacco products that do not bear the stamp or other marking required by the department [MCL 205.428 (2)].
- A felony and a fine of not more than \$50,000 or imprisonment for not more than 5 years, or both, for 3,000 or more cigarettes or tobacco products with an aggregate wholesale price of \$250 or more. This applies to 3,000 or more counterfeit cigarettes, 3,000 or more counterfeit cigarette papers, 3,000 or more gray market cigarettes, or 3,000 or more gray market cigarette papers [MCL 205.428 (3)].
- A misdemeanor and a fine of not more than \$5,000 or imprisonment of not more than 1 year, or both for 1,200 or more, but not more than 2,999, cigarettes, tobacco products with an aggregate wholesale value of \$100 or more but less than \$250 or 1,200 or more, but not more than 2,999, counterfeit cigarettes, counterfeit cigarette papers, gray market cigarettes, or gray market cigarette [MCL 205.428 (4)].

### ***Operating Without a License/Sales After License Revocation***

This is a criminal penalty that is generally imposed when a person is operating without a license or permit or a person sells cigarettes or tobacco products after the person's license has been revoked or suspended.

**Minnesota:** A person selling cigarettes or tobacco products after the person's license has been revoked is guilty of a felony (imprisonment for not more than 5 years or to payment of a fine of not more than \$10,000, or both [Minn. Stat. 609.03]) [Minn. Stat. 297F.20 (sub 8)].

## ***Refusal to Permit Authorized Examination or Inspection***

This is a criminal penalty that is generally imposed if a business refuses to allow an authorized person to examine or inspect the premises.

**Iowa:** Serious misdemeanor, up to 1 year in jail and a fine of between \$315 and \$1,875 [Iowa Code Title XVI, Subtitle 3, Chapter § 903.1.], [Iowa Code, §453A.45].

## **Examples of Interest Rate Calculations in Selected States**

Interest is generally charged on unpaid tax. Many, but not all, states also pay interest on overpayment.

**New Jersey:** Current rate is 6.25 percent. The rate is calculated as follows: prime rate (3.25 percent) + 3 percent = 6.25 percent compounded annually. Under the Taxpayers' Bill of Rights, interest assessed on outstanding tax balances is prime rate plus 3 percent. Prime rate for this purpose is the average predominant prime rate, as determined by the Board of Governors of the Federal Reserve System, which was in effect on December 1 of the year prior to the year in which the tax became due. At any time that the director determines that the prime rate varies by more than 1 percentage point from the rate previously determined, the director shall re-determine the prime rate to be that quoted prime rate for subsequent calendar quarters of the year in which the payments become due.<sup>22</sup>

## **Examples of Sanctions in Selected Survey States**

Taxing departments may impose sanctions that are usually related to suspension or revocation of a license/permit, loss of discounts, loss of ability to purchase tax stamps, and bonding.

### ***License Suspension or Revocation***

This sanction is widely used for a variety of violations of the tax acts and, when a license is suspended or revoked, a hearing is usually involved. When a license is suspended or revoked a business is prohibited from operating for a set period of time. Listed below are some of the reasons for a license suspension or revocation.

**Wisconsin:** Any permit holder who violates most sections of the Act and the Unfair Sales Act may have their permit suspended or revoked [Wis. Stat. 139.39 (3)].

In addition to the penalties imposed for violation of ss. 139.30 to 139.41 or 139.75 to 139.83 or any of the rules of the department, the permit of any

person convicted shall be automatically revoked and he or she shall not be granted another permit for a period of 2 years following such revocation.

### ***Seized/Forfeited Property***

**New Jersey:** Transportation of contraband cigarettes is a disorderly person offense and the vehicle used is subject to seizure and forfeiture by the courts.

The following are also subject to seizure and forfeiture:<sup>23</sup>

- Untaxed cigarettes, U.S. tax-exempt or duty-free, and counterfeit-manufactured cigarettes
- Cigarette vending machines that are not properly licensed or that contain untaxed cigarettes, or counterfeit-manufactured cigarettes
- Any vehicle, vessel, device, or paraphernalia used in the unlawful transportation of contraband cigarettes or used in the manufacture of counterfeit tax stamps
- Any monies that are the proceeds of the sale of contraband cigarettes

## **Examples of Unique Penalties and Sanctions in Selected Survey States**

Listed below are some unique penalties, and sanctions that JD Michael found in three or less of the particular states that were surveyed. See Appendix J for a complete listing.

### ***Penalty for Operating Without a Vending Machine License***

This penalty is generally imposed for failure to display a vending machine license.

**New York:** Retail dealer, first violation - \$5,000 to \$25,000; second or subsequent within 3 years - \$10,000 to \$35,000.

Owner/operator, first violation - \$750 to \$2,000; second or subsequent violation within 3 years - \$2,000 to \$6,000 [New York Code, Article 20 § 480-a].

## ***Personal Liability***

The state may generally hold a president, vice president, secretary, or treasurer, or other person having control or supervision of, or charged with the responsibility for making returns and payments, personally liable for the failure to comply with the statute. However, the state listed below also had a separate penalty associated with the personal liability.

**Michigan:** A person, other than a licensee, who is in control or in possession of a tobacco product contrary to the act, or is in control or in possession of an individual package of cigarettes without a stamp in violation of the act, or who offers to sell or does sell a tobacco product to another for purposes of resale without being licensed to do so under the act, shall be personally liable for the tax imposed by the act, plus a penalty of 500 percent of the amount of tax due under the act [MCL 205.428 Section 8 (1)].

## ***Failure to Keep Records***

This penalty is generally imposed when a business fails to keep proper invoices, books, or records.

**Virginia:** \$1,000 for each day that the person fails or refuses to allow an audit or inspection of the records [Code of Virginia, § 58.1-1007].

## ***Prohibited from Purchasing, Possessing, or Selling any Cigarettes or Other Tobacco Products***

This sanction is generally imposed when a retailer possesses or sells cigarettes on which the tax imposed has not been paid or accrued to a licensed wholesaler, secondary wholesaler, or unclassified acquirer, the retailer shall be prohibited from purchasing, possessing, or selling any cigarettes or OTP.

**Michigan:** A wholesaler, secondary wholesaler, or unclassified acquirer cannot sell cigarettes or OTP to a retailer after receipt of notice from the department that the retailer is prohibited from purchasing tobacco products. Any cigarettes or OTP found on the premises of the retailer during the period of prohibition are considered contraband and subject to seizure and constitute an additional improper possession. The retailer is prohibited from purchasing cigarettes or tobacco. First violation, for a period of not more than 6 months. For a second violation within a period of 5 years, for a period of at least 6 months and not more than 36 months. For a third or subsequent violation within a period of 5 years, for a period of at least 1 year and not more than 5 years [MCL 205.429 Section 9 (8)].

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# Section 5

## Sales of Tobacco to Youth

This section of the report is intended to address the specific question posed by the legislature — what can Minnesota do to “help to prevent illegal sale of tobacco products, which may make these products more accessible to youth?” In order to address this question, some contextual information is provided.

### Current Prevention and Cessation Efforts in Minnesota

The U.S. Centers for Disease Control and Prevention (CDC) recommends that Minnesota spend \$58.4 million a year to have an effective, comprehensive tobacco prevention program.<sup>24</sup> In fiscal year 2013 Minnesota allocated \$19.6 million for tobacco prevention and cessation.<sup>25</sup> This is 33.6 percent of the CDC’s recommendation and ranks Minnesota 12th among the states in the funding of tobacco prevention programs. Minnesota’s spending on tobacco prevention amounts to 3.7 percent of the estimated \$535 million in tobacco-generated revenue the state collects each year from settlement payments and tobacco taxes.

### State Comparative Information

The table below illustrates recent comparative information among states.<sup>26</sup>

**Table 5-1 Select Youth Cigarette and Tobacco Use Statistics**

State	State funding	Federal funding	Percent of CDC funding	State quit line Investment-per smoker (\$)
Alabama	\$275,000	\$3,044,925	5.9%	2
Alaska	\$10,873,300	\$951,597	110.5%	12
Arizona	\$15,200,000	\$2,196,906	25.5%	6
Arkansas	\$17,802,528	\$2,190,155	54.9%	14
California	\$62,095,000	\$6,532,450	15.5%	4
Colorado	\$22,567,704	\$2,288,576	45.7%	10
Connecticut	\$5,997,000	\$1,835,179	17.8%	6
Delaware	\$9,021,800	\$821,064	70.8%	14
Florida	\$64,289,944	\$3,164,145	32.0%	10
Georgia	\$700,000	\$2,254,535	2.5%	2
Hawaii	\$8,933,769	\$898,291	64.7%	18
Idaho	\$2,814,700	\$2,043,020	28.7%	8

State	State funding	Federal funding	Percent of CDC funding	State quit line Investment-per smoker (\$)
Illinois	\$11,100,000	\$2,600,641	8.7%	2
Indiana	\$9,251,037	\$2,371,788	14.7%	2
Iowa	\$3,653,830	\$1,586,023	14.3%	6
Kansas	\$1,000,000	\$1,933,751	9.1%	2
Kentucky	\$1,896,628	\$1,896,628	7.0%	2
Louisiana	\$7,170,101	\$2,079,892	17.3%	2
Maine	\$7,561,535	\$1,762,552	50.4%	20
Maryland	\$41,500	\$2,310,573	10.2%	2
Massachusetts	\$4,151,958	\$2,591,344	7.5%	4
Michigan	\$1,833,935	\$3,372,944	4.3%	2
Minnesota	\$19,600,000	\$1,807,799	36.7%	2
Mississippi	\$11,200,000	\$2,271,455	34.4%	4
Missouri	\$61,785	\$2,275,032	3.2%	2
Montana	\$4,600,000	\$1,075,049	40.8%	8
Nebraska	\$2,379,000	\$1,324,265	17.2%	2
Nevada	\$150,000	\$1,075,049	3.8%	2
New Hampshire	\$0	\$1,333,586	6.9%	14
New Jersey	\$0	\$2,601,594	2.2%	N/A
New Mexico	\$5,931,300	\$30,538	32.7%	12
New York	\$41,400,000	\$3,092,684	17.5%	4
North Carolina	\$0	\$5,706,444	5.3%	2
North Dakota	\$8,216,554	\$1,153,366	100.8%	20
Ohio	\$0	\$3,319,482	2.3%	0
Oklahoma	\$19,903,885	\$2,627,061	50.1%	14
Oregon	\$7,534,500	\$1,329,165	20.6%	6
Pennsylvania	\$14,221,000	\$2,942,883	11.0%	2
Rhode Island	\$376,437	\$1,847,143	14.6%	2
South Carolina	\$5,000,000	\$1,604,767	10.6%	10
South Dakota	\$3,999,830	\$963,055	43.9%	20
Tennessee	\$222,267	\$1,936,472	3.0%	N/A
Texas	\$6,450,294	\$4,331,461	4.0%	2
Utah	\$7,037,400	\$1,586,549	36.5%	8
Vermont	\$3,971,713	\$1,189,143	50.0%	8

State	State funding	Federal funding	Percent of CDC funding	State quit line Investment-per smoker (\$)
Virginia	\$8,371,777	\$2,907,480	10.9%	0
Washington	\$2,485,000	\$2,568,322	7.5%	4
West Virginia	\$5,650,000	\$2,132,328	28.0%	N/A
Wisconsin	\$5,315,000	\$2,064,385	11.5%	2
Wyoming	\$5,400,000	\$535,035	65.9%	20
District of Columbia	\$495,000	\$867,698	13.0%	12

N/A = Data not available

Source: The State of Tobacco Control, American Lung Association, 2013

In the report, only two states (Alaska and North Dakota) earned A's for sufficiently investing in their tobacco prevention and control programs. One state (Delaware) earned a B. However, the overwhelming majority of states earned an F because they failed to invest at least 50 percent of the CDC recommended level. However, these results are not very informative because the grade distribution is bimodal – a few states received A's and B's while the majority received F's. In addition, for example, North Dakota received an A but has one of the lowest tax rates in the country and does not stamp cigarettes.

## Youth Tobacco Sales

There are three major factors discussed in the literature that contribute to youth tobacco consumption.

- **Price of Cigarette and Other Tobacco Products.** Of all the states surveyed, all but three states – California, Missouri and North Dakota – have increased their cigarette tax at least once since 2000. However states have generally not moved to increase taxes on OTP, including smokeless tobacco, cigars, little cigars, and roll-your-own tobacco products, to the same degree. No states have equalized cigarette with OTP taxes. Pennsylvania remains the only state in the U.S. that does not tax tobacco products other than cigarettes.
- **Advertising.** In 2012, the Surgeon General called for hard-hitting mass media campaigns.<sup>27</sup>
- **New Product Development (including flavored product).** Recent research finds that the use of flavored cigars among cigar smokers is highest among young, poor, Hispanic, and lesbian, gay, bisexual, transgendered (LGBT) populations.<sup>28</sup> The report concludes that more than two-fifths of current cigar smokers report using flavored cigars. Disparities in flavored cigar use also exist across states and subpopulations. Electronic cigarettes, or e-cigarettes, are devices that allow users to inhale a vapor containing nicotine or other substances. Unlike traditional cigarettes, e-cigarettes are battery-operated and use an atomizer to heat a refillable cartridge that then releases a chemical-

filled vapor. E-cigarettes now come in dozens of flavors, including candy flavors, and are now advertised on television and have been sold by Groupon, an online company that advertises businesses and products by selling discount vouchers. Minnesota is the only U.S. state that currently taxes e-cigarettes.

## What Mix of the Product are Youths in the United States Consuming?

**Table 5-2 An Overview of the 2011 Youth Tobacco Survey Findings<sup>29</sup>**

<b>High School Students</b>	<b>Percentage of Black, Non-Hispanic</b>	<b>Percentage of Hispanics</b>	<b>Percentage of White, Non-Hispanic</b>
18.1% of all high school students who smoked one or more <b>cigarettes</b> (16.1% female and 19.9% male)	10.5%	17.5%	20.3%
13.1% of all high school students who were <b>cigar</b> smokers (8.0% female and 17.8% male)	13.3%	11.8%	13.5%
7.7% of all high school students who were <b>smokeless tobacco</b> users (2.2% female and 12.8% male)	3.1%	5.9%	9.3%

<b>Middle School Students</b>	<b>Percentage of Black, Non-Hispanic, and Asian</b>	<b>Percentage of Hispanic</b>	<b>Percentage of White, Non-Hispanic</b>
4.3% of all middle school students who smoked one or more <b>cigarettes</b> (4.0% female and 4.5% male)	4.9%	6.7%	3.8%
3.5% of all middle school students who were <b>cigar</b> smokers (2.5% female and 4.3% male)	6.3%	6.1%	2.3%
2.2% of all middle school students who were <b>smokeless tobacco</b> users (1.4% female and 3.0% male)	2.3%	2.9%	2.3%

Source: 2011 National Youth Tobacco Survey, Center for Disease Control, 2011

The most recent results from the Minnesota Student Survey (MSS) show that overall tobacco use is highest among American Indian students and lowest among Asian students at all three grade levels (6, 9 and 12 grades).<sup>30</sup> At the 12th grade level, for example, 40.1 percent of American Indian students and only 17.6 percent of Asian students reported using some form of tobacco in the last 30 days. By 12th grade, overall tobacco use has also reached high levels among Hispanic and White students. American Indian students have the highest rates for smoking cigarettes at all three grade levels, and among the highest rates for smoking cigars and

using smokeless tobacco. Asian students consistently are the least likely to use each form of tobacco.

A recently published study based on the 2011 National Youth Tobacco Survey focused on flavored product.<sup>31</sup> The authors found an overall prevalence of current use was 4.2 percent for flavored cigarettes, 3.3 percent for flavored little cigars, and 6.3 percent either product. Among current cigar smokers, 35.9 percent reported using flavored little cigars, and among current cigarette smokers, 35.4 percent reported using flavored cigarettes. Among current cigar or cigarette smokers, 42.4 percent reported using flavored little cigars or flavored cigarettes. Flavored product use among current smokers was higher among non-Hispanic whites than among blacks and Hispanics, higher among high school students than middle school students, and increased with grade. Among cigar smokers, prevalence of no intention to quit tobacco was higher among flavored-little-cigar users (59.7 percent) than nonusers (49.3 percent). The authors conclude that more than 40 percent of U.S. middle and high school smokers report using flavored little cigars or flavored cigarettes, and disparities in the use of these products exist across subpopulations. They call for additional efforts to reduce flavored tobacco product use among youth.

### **How are Youth Obtaining Cigarette and Tobacco Products?**

According to the Campaign for Tobacco-Free Kids, youth smokers obtain cigarette and tobacco products as follows:<sup>32</sup>

- More than half of all youth smokers usually buy the cigarettes they smoke either directly from retailers or vending machines, from other kids, or by giving money to others to buy for them.
- Roughly one-third typically get their cigarettes from others (usually other kids) for free.
- The remainder is obtained by shoplifting or other stealing.

However, it should be noted that where and how youth smokers get their cigarettes can vary considerably from state-to-state or city-to-city depending on such factors as to whether or not

- the jurisdiction strictly enforces the laws prohibiting tobacco sales to minors;
- there is a requirement for retailers to keep cigarettes behind the counter; or
- cigarette vending machines have been banned or have been restricted to adult-only locations.

In Minnesota, over two-thirds of smokers under 18 (66.9 percent middle school; 72.3 percent high school) get their cigarettes through social sources, such as borrowing cigarettes or giving someone else money to buy for them.<sup>33</sup> About 10 percent (9.7 percent) of underage high school smokers usually get their cigarettes by purchasing them in a store.

The percentage of high school underage smokers who bought their own cigarettes directly from a store did not change between 2008 and 2011. Over the long-term, the percentage who were able to get their cigarettes through a direct purchase in a store declined from 15.9 percent

in 2000 to 9.7 percent in 2011, a statistically significant change. This trend drawn from the youth tobacco surveys is mirrored by a similar trend drawn from compliance checks of retail outlets. A statewide program of random undercover compliance checks found that underage teens were able to buy tobacco products in 4.1 percent of stores tested in 2010. This is down from 19.2 percent of stores tested in 2000. Greater enforcement of laws prohibiting sales to minors and stronger education programs for retail stores are often cited as reasons for this success.

Minnesota will see an overall increase in cigarette and OTP tax avoidance and evasion resulting from the recent tax increases if everything else, such as enforcement measures, remains unchanged. For youth in particular, research finds that increases in price have a significant impact on consumption. If JD Michael makes the reasonable assumption that illegal cigarette and other tobacco tax products will sell for a price that is lower than legal tobacco products, JD Michael can conclude that the impact on youth consumption of tobacco products resulting from the recent tax increase will be tempered.

### **States with Innovative Practices**

JD Michael posed the following question to Minnesota-based groups having youth prevention as part of their mission — “Please identify states you have the most positive impression of in terms of their enforcement efforts.” The following states were identified:

- California
- Massachusetts
- New York
- Minnesota

Some characteristics identified as being innovative include

- the licensing of the complete supply and distribution chain,
- adoption of a high technology stamp,
- cooperation among all agencies involved in enforcement,
- increased civil and criminal fines and penalties, and
- a state’s willingness to prosecute.

### **Research Recommendations**

Research could be conducted to determine to what degree youth in Minnesota consider tobacco products substitutes. Based on these results, state tax rates could be adjusted accordingly. If the goal of youth cigarette and tobacco policy in Minnesota is to reduce tobacco consumption, taxing the various components at different rates will make achieving the goal less realistic. From this substitutability standpoint alone, the federal government and the states could consider taxing all tobacco products at similar rates.

An evaluation of California’s comprehensive approach to enforcement could be conducted.

Based on the above findings, the following ideas are intended as a summary of suggestions contained in the literature and from feedback from Minnesota-based organizations with youth tobacco prevention as part of their mission. Many of these ideas have been discussed earlier in the report and apply not only to reducing youth consumption, but to increasing overall tax compliance.

- License all participants in the supply and distribution chain, including a state-level retailer's license.
- At a minimum, require vending machine licenses. Alternatively, consider outlawing vending machine sales.
- Raise the legal age for buying cigarette and OTP from 18 to 21, as recently occurred in New York City.
- Equalize effective tax rates to make OTP taxable at the same effective rate as cigarettes.
- Increase the number of scheduled and unscheduled retail inspections. The effectiveness of this strategy toward combatting youth tobacco consumption is somewhat controversial, as survey results indicate that most cigarette and OTP consumed by youth are not obtained directly from retailers.
- Work closely with the industry to determine feasibility of stamping OTP that do not currently require a stamp.
- Require unique serial numbers on stamps.
- Coordinate regular enforcement with efforts to stop illegal sales to youth.
- Increase criminal and civil penalties.
- Explore partnerships between public health, law enforcement, and revenue agencies.
- Work with the judicial system to understand and overcome impediments to prosecute.
- Monitor trends in e-cigarettes, given that they are outlawed in some countries.
- Work to expand coverage of the Prevent All Cigarette Trafficking (PACT) Act to all tobacco products.

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# Section 6

## High-Technology Alternatives

This section is intended to give an overview of the high technology products available to enhance cigarettes and other tax products (OTP) tax enforcement efforts. A wide variety of technologies are available in today's market that can meet the requirements of most revenue collection and enforcement agencies. A wide variety of different types of technologies are available in today's market that can achieve what most revenue collection and enforcement agencies are looking for.<sup>34</sup> State tax agencies are looking for a product/technology that

- will help ensure that the appropriate tax is collected on cigarette and OTP;
- can be placed on cigarette and OTP packaging;
- will be difficult to counterfeit;
- is cost effective;
- will capture data such as brand, brand family, tax rate, and the date of sale; and
- track cigarette and OTP from "cradle to grave" (*i.e.*, when the product was manufactured and every point where the product was sold along the distribution chain).

Some of the more popular types of technologies currently available and which can be used in tax stamps/indicia (distinctive mark) are listed and defined below.<sup>35</sup> Note that a company that produces tax stamps or alternative tax indicia may incorporate multiple technologies in their product in an effort to drastically reduce the ability to counterfeit the tax stamp/indicia and provide a better track and trace solution.

### Definitions

**Authentication:** A method to verify whether a product is genuine. In most countries, customs authorities rely on the tobacco industry to determine whether a product is genuine or counterfeit.

**Barcodes:** A way to represent information that can be read electronically by a machine. The first barcodes stored information in patterns of parallel lines of varying width and spacing from each other. The newer two-dimensional (2D) matrix code, as it is called, contains more data and stores information in patterns of dots, circles, and images (See Quick Response Code and Code Verification System). Barcodes can also be used for tracking a product's movement.

1D Bar Code



2D Matrix



**Barcode reader (or barcode scanner):** An electronic device used to read printed barcodes.

**Cigarette packaging:** Cigarette packs generally contain 20 cigarettes, cartons contain 10 packs or 200 cigarettes, and master cases most commonly contain 50 cartons or 10,000 cigarettes.

**Code Verification System:** A 2D barcode scheme. When used on a pack of cigarettes, it makes use of a unique encrypted 12-character number to identify and authenticate a pack of cigarettes. The number, linked with a digital signature, can be read by a human or by a computer. By introducing the number into a data base or scanning the code, a code-verifying computer program determines whether or not the code is authentic. The code can contain information such as the place of manufacturing, the date and time of production, and the brand.

**Counterfeit products:** Products that bear a trademark without a trademark owner's consent.

**Covert features:** Features that are hidden from the human eye (e.g., invisible ink).

**Data Matrix:** Is a 2-D matrix barcode consisting of black and white "cells" or modules arranged in either a square or rectangular pattern.<sup>36</sup>

**Digital tax stamps:** A digital tax stamp can incorporate one or more of the technologies listed in this section of the document. Digital tax stamps can be thermal (heat applied) or pressure applied and have unique codes and features that allow their authentication and the electronic tracking of legally issued tax stamps. The main objective of digital tax stamps is to improve collection of tax revenue.

**Electronic Product Code:** Feature that goes beyond a barcode and helps identify a manufactured product.

**Forensic:** Relating to the use of scientific knowledge or methods in solving crimes relating to, used in, or suitable to a court.<sup>37</sup>

**Invisible ink:** Ink used in many new high tech, digital stamps and can feature a unique, covert code with data for each pack of cigarettes. When used in a tax stamps, this technology provides the capability to verify whether products are authentic or counterfeit, and can be encrypted with extensive information that is uploaded to a Central Data System.

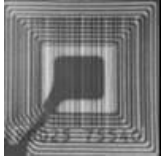
**Overt features:** Features that are visible to the human eye.

**Physical fingerprints:** An industry term used to identify a method that relies on a product's microscopic structure. A science writer explained it this way — “On the microscopic scale, paper is made up of tiny fibers in random orientations, which is unique in its structure. On a mass production line, each product is scanned and its unique laser fingerprint is recorded on a protected database”<sup>38</sup>. This technique can be used for mass consumer products, but its cost might explain why it is not used more commonly.

**Quick Response Code (QR):** A Matrix Code (2D barcode). Codes are decoded at high speed and point to programmed information. This code can be scanned by enforcement personnel to access an electronic tracking system.

**Radio-frequency identification (RFI or RFID):** Allows identification of a product and tracks it by use of a microchip, an antenna, and transmitters (readers) that use microwaves and is sometimes referred to as a smart tag. When a smart tag nears a reader, the tag broadcasts information stored in its chip. Readers can scan smart tags automatically when pallets with products bearing the tags pass along conveyor belts and through loading bays.<sup>39</sup>

Example of RFI



**SAP<sup>40</sup>:** Provides customers with the ability to interact with a common corporate database for a comprehensive range of applications.

**Taggant:** A chemical element added to the ink that can be recognized by a scanner. The taggant enables an individual to determine if the products are genuine or counterfeit when a hand-held reader is used.

**Tracing:** Recreating of the route taken by products through their supply chains.

**Tracking:** Monitoring of the route taken by products through their supply chains.

**Tracking and tracing systems:** A systemic method that uses a secure and unique product code which identifies the product; transmission of the product code through scanning, manual uploading or radio emission; and a data server.

## Tax Stamp/Indicia Solutions Available in the United States

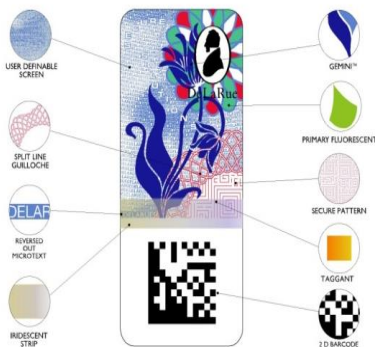
**De La Rue Stamps and Codes.**<sup>41</sup> This company provides solutions from the initial manufacture of paper and bespoke designs for paper or heat applied stamps through to full personalization, tracking, mobile authentication, reconciliation, and management of data. The company provides a central database with secure connections. This security controlled access extends to all relevant parties and locations, provides the ability to share information which allows interrogation of data with reporting and audit functionality, allows for code lifecycle tracking throughout the supply chain, and permits mobile verification of unique product codes and real time authentication of legitimate trade.

De La Rue produces a self-adhesive high security cigarette stamp that incorporates:

- tamper-evident, frangible paper,
- a 2D data matrix code,
- a unique identifier, and
- a range of anti-counterfeit security features utilizing complex printed ink and multiple level security feature solutions (overt, covert and forensic).

The 2D matrix barcode allows the traceability of the stamp from production to destruction by incorporating the following features:

- **Order Management** – Provides a secure portal for the state and/or their stampers to place orders for stamps and for those orders to be authorized and then tracked through to delivery. In sum, it provides a complete audit trail of stamps ordered and delivered, and allows for historical reporting.
- **Product Association** – Digital stamping machines are used to scan product data and to associate it to the unique label applied to the pack. This provides data pertaining to packs stamped and stamps assigned. It also ensures only valid product is stamped.
- **Authentication** – Encrypted cell phone authentication allows law enforcement and nominated stakeholders to verify the tax is paid on the correct product and from where the product was distributed.
- **Reporting** – Data supplied by the Order Management System can be used to analyze data to help target operations and provide intelligent information to enforcement teams.



The company's adhesive system is water-based and pressure sensitive, designed for processes that require fast application, high tack, and a long shelf life.

De La Rue has introduced tax stamps in more than 20 countries and currently provides governments in Cameroon, Kosovo, Latvia, Malawi, Rwanda, and Uzbekistan with critical anti-counterfeit and traceability technology.

**Note:** De La Ru is a registered trademark of De La Ru Holdings plc.

**Neenah Stamps.**<sup>42</sup> Neenah Paper, Inc. and ProofTag™ have partnered to create tax stamps with recording, verification, and track and trace capabilities. Bringing together their areas of expertise, the two companies have collaborated to produce a tax stamp with two covert and three overt security features.

Printers and designers can create a high security tax stamp with covert, overt, and forensic features. The Neenah Secure™ Label Paper fiber generation process creates a platform of security and provides unique and visible proof of authenticity. Fibers make the indicia as unique as is the identity of persons. The fiber provides a “digital fingerprint” that consists of a unique fiber orientation matched with a serialized unitary 2D code. The Neenah Secure™ Label matches the fiber to the unitary 2D code, allowing instant document tracing and tracking. What this implies is that the tobacco product is traceable at the item level throughout its lifecycle. (Traceability begins with product creation and continues through shipment and final sale.)

ProofTag™ provides an ordering process for mass serialization and recording of each individual stamp which builds in additional and innovative security features. Application of a tax stamp with Neenah Secure and ProofTag™ triggers the security record and activates the tax stamp. When the 2D code and fiber fingerprint are matched, this security record can be verified on-demand in real time with smart phones, computers, or other reader devices for efficient law enforcement and collection of taxes.



**Note:** Registered trademarks - FiberTag® label Neenah Secure® paper

**Sekuworks Tax Stamps.**<sup>43</sup> Sekuworks offers a traditional thermal stamp and a brand new type of stamp which is the only *Hybrid Thermal/Digital Cigarette Tax Stamp* solution on the market. For purposes of this report, JD Michael will focus only on the new Hybrid Thermal/Digital stamps.

Sekuworks product provides all the features of the traditional stamp while adding measurement, management, tracking, and traceability features in real time. This solution offers full digital cigarette tax stamping information that can then be transferred into an electronic tax reporting and compliance/enforcement system. It uses the same application equipment as the more traditional stamp so no additional major capital purchase is required. The company states that the hybrid stamp “has all the advantages of a pressure sensitive digital solution at a fraction of the cost.”

Stamp features and software functionality can be customized and error correction is built into the QR (digital) code portion of the stamp to allow for the scanning of a damaged code.



The stamp features include a variety of bold colors, and text that is clearly visible. Unique stamp security features are layered to significantly reduce counterfeiting, aiding enforcement. Numerous security features are available; some features are confidential and/or may be customized. The stamps are manufactured in a North American Security Products Organization (NASPO) Certified Class One facility which assures security and accountability.

The company has performed numerous tests to ensure that the stamp has superior transfer quality and adhesion which result in improved counterfeit detection.

This stamp can be applied using the same equipment currently used for other thermal stamps, thereby eliminating the capital investment to obtain digital/software capability.

This company also offers compliance software that measures, manages, and tracks (MMT) in real time, and provides operational, tax collection and compliance information. The software can be easily integrated with new or existing revenue/tax reporting systems, and can be customized to allow for comprehensive information collection, configuration, analysis, and reporting.

Three different digital implementations allow a state to ease into the new digital operations measurement and tracking. Currently Wisconsin, Ohio, Pennsylvania, New Hampshire, and Cook County in Illinois as well as some tribal regions are using Sekuworks tax stamps.

**SICPA Tax Stamp.** SICPA incorporates multiple layers of anti-counterfeiting technologies in their tax stamps. Stamp features include, overt, semi-covert, covert and forensic security levels. They include color shifting/single and dual polarizing inks, improved stamp chemistry for optimal adhesion, innovative stamp designs, and enhanced invisible features such as taggants. Pressure applied stamps come with **SICPATRACE®**. **SICPATRACE®** is a multi-product track-and-trace platform that provides a scalable system that enables deployment initially to cigarettes with the ability to expand to OTP. The platform uses a layered security approach, combining material and information based securities. It merges overt and covert counterfeit deterrent features in the printed design of the tax stamp with encrypted information-based services. There are no limits on the amount of data that can be attributed to the secure stamp (e.g., name and address of the distributor affixing the stamp, the date the stamp was affixed, and the value of the stamp) and as long as the stamp is read along any point of the supply chain, its history is maintained in the system. Additionally, the platform allows for authorized third parties (i.e., retailers and distributors) to authenticate and access certain information from the stamp via mobile devices. This information is separate from the encrypted information, which cannot be accessed by the public. Law enforcement personnel are equipped with dedicated mobile scanners that are only available to state authorized personnel and provide them with access to a whole range of encrypted data.



Sample SICPATRACE® stamp



Sample SICPATRACE® stamp with QR code

SICPA provides the state with complete ownership of the critical data collected. SICPA's data capture components are implemented as part of its contract and not outsourced to a third party. SICPA has developed a number of new features. These include, but are not limited to, the following:

- **Heat-applied track and trace** - Provides field data capture and is fully capable of integrating with current cigarette tax stamping program.
- **Direct-to-distributor shipping** - Stores the stamps at SICPA's secure production facility and ships them directly to the distributors. (The state has absolute control over the ordering system.)
- **E-reporting** - Captures distributor sales invoicing information and crosscheck it with other data sources, enabling the state to expose illicit activity, assisting inspectors with the validation of retailer inventory, and supporting enforcement of non-stamped products such as OTP.
- **Integration with state IT systems** - All of SICPA's solutions are fully compatible with all ITS systems providers (e.g., GenTax®).

SICPATRACE® stamps are currently being used in California, Canada and Massachusetts. In Canada, stamps are applied to both cigarette packs and OTP.

**Xerox Tax Stamps.** Xerox, in combination with its partner OpSec Security, Inc. (OpSec), has developed a new pressure sensitive tax stamp with a protected holographic imprint called SecureITTTM.<sup>44</sup> The Secure Intelligent Tax Tag (SecureITT) was created by OpSec, a company specializing in anti-counterfeiting technology. SecureITT combines physical stamp characteristics, electronic security features, and digital reporting data with Xerox's eTRACS (Electronic Tax Reporting and Audit Compliance System) tracking software. SecureITT includes visual effects such as movement or color changes within the Optical Variable Device (OVD).

The QR code contained in the stamp can be scanned by enforcement personnel to access Xerox's electronic tracking system. Using a laptop, tablet, or smart phone the officer scanning the SecureITT stamp will be vetted and directed by eTRACS depending upon the source of the officer's query. eTRACS requires identification from the officer and device querying the QR code and then, depending upon security access rights, will display all relevant data back to the officer including the stamp, product, manufacturer, shipment(s), order(s), and retail location. The system aids enforcement personnel in identifying whether the SecureITT stamp is an authentic label, and whether or not taxes have been paid.

The Xerox OpSec cigarette tax stamp program includes the following products and services with the price of the stamp:

- Fully integrated electronic cigarette tax reporting system reconciling individual tax stamps to monthly tax reports
- Virtual stamp forensics lab for enforcement personnel to support onsite investigations
- Online account application, licensing, and surety management
- Contraband Watch Services trolling the Internet and social media looking for usable evidence of counterfeiting and illicit tobacco sales
- Online stamp ordering and inventory controls for both the state and stamper community
- Third party data interchanges for U.S. Customs, external states, Master Settlement Agreement (MSA) and PACT Act reporting
- Electronic payment, credit, and refund processing
- Public portals directing citizens to smoking cessation, minor smoking, and tipster pages to promote health and enforcement initiatives
- Workflow management and user access control
- No-charge stamp design changes should the tax stamp become compromised by counterfeit organizations
- Automated desktop auditing dashboards and compliance monitoring
- Secured stamp delivery to state lockbox locations or directly to licensed stampers



Xerox was recently awarded a contract to provide a digital cigarette stamp for Michigan.<sup>45</sup> The stamp contains over 10 different overt, covert, and forensic security devices.



## Tax Stamp/Indicia Solutions Available in Other Countries

What follows is a discussion of technologies used in foreign countries. Some of the solutions do not lend themselves directly to the U.S. experience because, unlike the U.S., many foreign countries apply tax stamps at the manufacturer rather than the distributor level.

**Philip Morris International Solution – Codentify™.** The Codentify™ technology can replace paper stamps with secure digital tax stamp markings.<sup>46</sup> No special reading equipment is required and the system runs on standard and off-the-shelf equipment. With the Codentify solution, all master cases are marked with a unique identifier worldwide and the code can be authenticated by every actor in the supply chain – authorities, distributors, retailers, and consumers. The tracking and tracing information is available through the complete supply chain which includes up to the retail level in several markets.

It should be noted that Tobacco Control, an international peer review journal covering worldwide tobacco use, effects, education, and activities of the tobacco industry and its allies, indicates that the claims made by PMI about its product may not be accurate.<sup>47</sup>

Example of Philip Morris International Switzerland Stamp.<sup>48</sup>



**British American Tobacco Track and Trace Solution SAP Solutions and Services.** The British American Tobacco Track and Trace solution works by unique computer-generated codes (bar codes) printed onto labels that are applied to cartons as they pass along a manufacturing line.<sup>49</sup>

These bar codes are scanned as the cartons are packed into master cases normally containing 10,000 cigarettes, which are also marked with unique codes and scanned – linking the cartons to the master cases into which they are packed.

British American Tobacco uses Movilitas Consulting AG SAP object event repository (OER) as its SAP implementation partner. SAP OER can record links from cartons to their master case and from their master cases to their pallet. SAP OER already had a built-in hierarchy function as part of its standard software.

## **Types of Technologies that are incorporated in Products Used in the United States and in Other Countries**

**Barcodes:** As part of European Union (EU) agreements, both Philip Morris International (PMI) and Japan Tobacco (JTI) are marking master cases with a unique barcode that can be read by a human or computer. The coded information includes the brand category, the product variant (a design of a cigarette package for a certain market), production date, place of production, the machinery, and the hour, minute, and second of manufacturing.

As part of its agreement, PMI is experimenting with a 2D matrix code on the cellophane wrapping tear tape. The matrix code is unique for each carton. The code is scanned at the production line and entered into a database, which links each carton with a specific master case. The barcodes are standardized internationally and can be read by scanning machines or readers that don't require a specific computer program to transmit the data. Their disadvantage is that they are labor-intensive because codes have to be scanned, are visible, and are easy to counterfeit or cut. However, 2D barcodes have typically been viewed as more effective than RFID.

**Code Verification System (CVS):** PMI uses the CVS and claims that it is low cost and easy to administer. However, one concern is that the company that makes products administers their own verification as opposed to independent verification by an entity without an interest in the outcome.

CVS is one of the few products being used for OTP. It is being used on some cigar boxes. The code is placed on a cigar box before it is sealed and on a paper ring put around each cigar before it is wrapped in cellophane. The Codentify™ technology is being used in 48 different countries including Argentina, Aruba/Curacao, Australia, Brazil, Colombia, Costa Rica, Czech Republic, Dominican Rep., Ecuador, Germany, Greece, Guatemala, Indonesia, Kazakhstan, Lithuania, Malaysia, Mexico, Pakistan, Philippines, Poland, Portugal, Romania, Russia, Senegal, Serbia, South Korea, the Netherlands, Turkey, Ukraine, Uruguay, and Venezuela.

**Invisible ink:** In California, Massachusetts, Michigan, Brazil, Canada, and Turkey, high-tech, digital tax stamps that use invisible ink and feature a unique, covert code with data for each cigarette pack are used.

The advantage of invisible ink is security – the ink is invisible and difficult to counterfeit. The disadvantage is that scanners for reading the code are developed specifically for each supplier of invisible ink and for each country. For example, outside Brazil, law enforcement officials cannot read the codes of the Brazilian tax stamps unless Brazilian authorities supply the scanners.<sup>50</sup>

**Taggant:** British American Tobacco products carry a taggant on the self-adhesive tear-tape. Taggant is used in many of the cigarette tax stamps produced in the U.S. and is included in heat applied and pressure applied tax stamps.

**Digital tax stamps:** Digital tax stamps are being used in a few U.S. states and in some foreign countries. Digital tax stamps may contain one or more of the technologies listed earlier in this section of the report.

**California** – Stamps are encrypted with the name and address of the distributor affixing the stamp, the date the stamp was affixed, and the value of the stamp. Retailers and distributors detect counterfeit stamps by using specific hand-held scanners or color shift cards. Law enforcement field inspectors are equipped with more sophisticated scanners, which give them access to range of product-specific data. Investigators can scan codes on the tax stamps at the point of retail sale, verify whether appropriate stamps are affixed to corresponding packs of cigarettes, and cross-check a distributor's name, address, and stamping date against the distributor's invoice to a corresponding retailer. Each year, inspectors visit approximately 10,000 retailers out of a total of 40,000.<sup>51</sup> Results of this system have been evaluated favorably.<sup>52</sup> In conjunction with using digital stamps and increased inspections, California has also established fines of up to \$25,000 for possessing, selling, or buying counterfeit cigarettes or fraudulent cigarette tax stamps.<sup>53</sup>

**Massachusetts** – In May 2010, the SICPATRACE® solution became operational in Massachusetts and it reached full implementation by March 2011.<sup>54</sup> Massachusetts Department of Revenue has contracted with SICPA Product Security, LLC to provide the Commonwealth's new counterfeit-resistant cigarette excise stamps. As part of SICPA's Affirmative Market Plan, they have partnered with Sterling Printing and Business Products to sell and distribute the SICPA Oasis Validators to retailers throughout the Commonwealth of Massachusetts for \$20 plus sales tax and shipping charges. These validators allow retailers to determine if the stamps in their inventory are authentic, which also enables the retailer to participate in the revenue enforcement process.<sup>55</sup>

**Canada** – In 2010, Canada implemented a high-tech tax stamp compatible with track and trace database technologies. Although the track and trace feature is not currently utilized, it can eventually be phased in.<sup>56</sup>

**Brazil** – A digital stamp is in place, with capabilities of identifying each individual pack of cigarettes. This is in addition to an integrated control and monitoring system and automatic cigarette production counters at each production line. The high-tech tax stamps are produced in the Brazilian Mint. Each stamp gets a unique code for each cigarette pack and a camera at the production line activates codes on the packs. The codes contain product data for each cigarette pack, which is uploaded to a data manager server under the control of the Ministry of Finance. The stamps are encrypted with the name of the manufacturing site, the date the stamp was validated, and the tax category of the stamp. The law stipulates that tobacco manufacturers must pay the costs of introducing the digital tax-stamp system.<sup>57</sup> It should be noted that Brazil is a country that does not allow for the importation of cigarettes.<sup>58</sup>

**Turkey** – A digital tax-stamp system, similar to the system in Brazil, using invisible ink and featuring a unique, covert code with product data for each cigarette pack, was introduced in Turkey in 2007.<sup>59</sup> The system applies to cigarettes made in Turkey and to legally imported cigarettes. For domestically made cigarettes, codes on the tax stamps are activated at the manufacturing site, and for imported cigarettes, they are activated in one of the three customs ports.<sup>60</sup> All cigarette packs sold in Turkey are marked with a tax stamp, printed by the authorized company SICPA. A non-visible 2D data matrix is embedded in the tax stamp carrying a unique serial number for each cigarette pack to be sold in the country. The Turkish tax stamps are only used for the domestic Turkish market and can only be read using SICPA scanners.

### **Reasons for Limited Adoption of High Technology Products**

In recent years, increased competition has occurred in the high technology stamp market, creating new options and resulting in lower costs. While states are slowly beginning to look at the options for newer digital tax stamp/indicia and tax stamp solutions, cost continues to appear to be the main reason for limited adoption. Rather than thinking of high technology stamps as a solution in and of itself, states need to develop a multipronged compliance strategy that would include licensing at all levels of the supply and distribution chain, performing more frequent scheduled and unscheduled inspections, and reviewing civil and criminal fines and penalties.

Currently 3 states use a digital stamp product: California, Massachusetts, and Michigan. Given recent downward pressure on the costs associated with this technology and that it appears to be one significant component in a 21<sup>st</sup> century enforcement strategy, MDOR should revisit the cost effectiveness of adopting this high-technology product.

# Section 7

## Recent Issues and Innovative Practices in Other Countries

This section of the report discusses collection and enforcement used by other countries that are significantly different from the practices used in the U.S. Countries from this survey include Australia, Brazil, Canada, China, Ireland and the United Kingdom (U.K.), and the Ukraine.

### Australia<sup>61</sup>

Australia's plain-packaging law took effect on December 1, 2012.<sup>62</sup> This law requires that all cigarettes must be sold in identical approved-color packs ("drab dark brown") with the brand name set in standardized type. New Zealand, the U.K., and India are currently contemplating adopting plain-pack laws.<sup>63</sup>

In response to new plain packaging, a former policeman wrote that he felt that the plain-packaging proposals make the job easier for counterfeiters.<sup>64</sup> "If plain packaging goes ahead, counterfeiters who currently have to copy hundreds of different cigarette pack styles, will instead have just one style. Although packs would have covert markings to help law enforcement officers identify counterfeits that would be of no help to consumers. So be under no illusion, organized criminals will exploit any advantage. Much of the money generated by counterfeit tobacco helps to fund more serious organized criminal activity. This includes armed robbery, drug crime, people trafficking, money laundering, and arms trading. So on top of all the problems law enforcement agencies face trying to keep a lid on tobacco smuggling, plain packaging will simply make the task harder, and make life easier for the criminals."

### Brazil<sup>65</sup>

According to the Brazilian Ministry of Finance, some 21 billion cigarettes were smuggled into Brazil in 2006, representing a loss of revenue of \$340 million.<sup>66</sup>

To address illicit domestic manufacturing, Brazil mandated licensing of its manufacturers. Non-compliance with the law or failure to pay taxes can lead to withdrawal of a license and closure of a factory. In addition, an integrated control and monitoring system for cigarette production became obligatory and has been operating since December 2007. The Ministry of Finance implemented installation of automatic cigarette production counters at each production line. It also mandated the launching of a digital tax stamp system, with capabilities for identifying each individual pack. Brazil is one of a handful of countries that has banned the sale of e-cigarettes.<sup>67</sup> In conclusion, research suggests that Brazil has one of the most comprehensive approaches internationally.

## Canada<sup>68</sup>

Tax rates for cigarettes and OTP vary within each province. For cigarettes, the tax per carton ranges from \$24.70 in Ontario to \$58 in Manitoba. For cigars, the tax ranges from 56 percent of the retail selling price in Nova Scotia to 130 percent of the taxable price in Yukon. For OTP, the range is usually based on the product and grams and is anywhere from 0.129¢ to 30¢ per gram. As noted throughout this report, large variations in tax rates and hence prices provides an incentive for smuggling and tax evasion. As of 2009, the value of the illegal cigarette industry was estimated at \$1.5 billion.<sup>69</sup> In addition to variations in tax rates within Canada, cigarettes are less expensive in New York State compared to average rates in Canada. This differential provides Canadians with an incentive to purchase cigarettes in New York State and bring them back across the border.

The Royal Canadian Mounted Police (RCMP) estimates about fifty contraband tobacco manufacturers are operating on First Nations territories in Ontario and Quebec.<sup>70</sup> The report states that dozens of organized crime groups are involved in the distribution of illegal smokes and reinvesting the profits they make into other crimes, including the trafficking of illicit drugs, firearms and human smuggling. In 2012, Project O-Titan was launched, spearheaded by the RCMP, and tracked five different groups smuggling cigarettes and trafficking marijuana. This tobacco-smuggling ring between Canada and the U.S. was broken up by police, leading to the arrest of nearly 40 people. Several police departments, the Canada Border Services Agency, and Ontario's Ministry of Finance were involved in the investigation. Police seized guns, more than a dozen vehicles, boats, drugs and nearly 12,000 cartons of contraband cigarettes. The smuggling of illegal cigarettes through Cornwall has been increasing in recent years and the RCMP has devoted more resources to curb it. A police statement issued indicated that "the success of this investigation underscores what can be accomplished when law enforcement works co-operatively towards eliminating the threat of organized crime within our cities."<sup>71</sup> This is a successful example of inter-agency cooperation.

Other examples of cigarette smuggling activities in Canada are:

- Dino Bravo, a former World Wrestling Federation wrestler was shot seven times in the head. It was alleged that Bravo was murdered because he was skimming from an organized crime smuggling network for which he collected the money. In an interview, a Canadian smuggler added that Bravo had purchased a cigarette relabeling operation in Champlain, New York, that repackaged and relabeled cigarettes, which Canadian-based manufacturers sent to the U.S. The cigarettes were then smuggled back into Canada.<sup>72</sup>
- In 1996, U.S. Customs agents arrested Michael Bernstein, a B&W regional sales manager, Richard Wingate, B&W's sales account manager for the New Orleans area, and six others and charged them with trafficking cigarette contraband into Canada. All defendants pleaded guilty.<sup>73</sup>
- In 2006, farmers reported they were being approached by counterfeiters that wanted to buy their entire crop and also that tobacco was being stolen from their barns.<sup>74</sup>

Penalties in Canada are significant.

- A conviction for illegally possessing more than 200 cigarettes, 200 tobacco sticks, or 200 grams of manufactured tobacco can lead to a fine of up to \$10,000, jail up to 30 days, or both fines and jail for a first offense. On conviction for a second or subsequent offense, the fine can be up to \$30,000, jail up to 6 months, or both fines and jail.
- A conviction of having more than 1,000 cigarettes or tobacco sticks, more than 1,000 grams of fine cut tobacco, cigars containing more than 1,000 grams of tobacco, or any combination containing more than 1,000 grams of tobacco without a permit can result in a fine of up to \$20,000, 6 months jail, or some combination. A second offense can result in a fine of up to \$50,000, 1 year in jail, or some combination of the two.<sup>75</sup>
- Failure to pay fines can result in up to 18 months in jail.

While these statutory fines and penalties are significant, and some of the highest found during the course of the study, prosecutors claim that smugglers often do not show up in court, which means police have to go looking for them. When smuggling cases eventually do come to court and result in fines of often tens of thousands of dollars, the defendants frequently do not pay them. “In my four years doing these cases I have never seen anybody incarcerated for failure to pay a fine,” Cornwall public prosecutor Ron Turgeon said, adding that nobody pays the fines. “They get fined hundreds of thousands of dollars and nobody actually pays that money,” said Sergeant Michael Harvey of the Cornwall detachment of the RCMP. “They pay maybe \$100 a month. It’s just crazy. We seize loads every day but there are 13 factories pumping out millions of cigarettes so it doesn’t make any dent.”<sup>76</sup> “Now I’m asking for prison for a second offense, but I’m still not getting it.”

## China<sup>77</sup>

China grows one-third of the world’s tobacco crop, and is the largest producer and consumer of tobacco in the world.<sup>78</sup> There are 300 million Chinese smokers, 36 percent of China’s population over the age of 15.

Research indicates that suppliers in China export through Eastern Europe, Greece, and Italy.<sup>79</sup> Currently, there are about 400 billion counterfeit cigarettes being produced in China.<sup>80</sup> About half of all counterfeit product in China is manufactured in Yunxiao, a county in the south of China roughly twice the size of New York City and home to 200-plus counterfeit cigarette operations.<sup>81</sup> Yunxiao’s illegal cigarette factories are actually hidden below the surface of the city, in neighboring mountain caves and under streets, temples, and even a lake. Counterfeit Chinese cigarettes often contain 80 percent more nicotine and 130 percent more carbon monoxide than the genuine article.<sup>82</sup>

Chinese counterfeit cigarettes are exported to over 60 countries around the globe. Ninety-nine percent of all counterfeit cigarettes in the U.S. come from China.<sup>83</sup> In the U.K., one in every three packs is believed to be a Chinese counterfeit.<sup>84</sup> The return on investment for such ventures can be up to 20 times.

China does seem to be taking steps to reduce illicit cigarette trade. For example in August 2013, it was reported that approximately 5 million illicit cigarettes were seized by the Customs and Excise Department in a one-week special operation to combat the smuggling of cigarettes from the mainland to Hong Kong through a cross-boundary logistics network.<sup>85</sup> The total market value of the cigarettes alone in the three seizures was about HK\$12 million with a duty tax potential of about HK\$8 million. In one of the seizures, the department also netted 5,000 counterfeit mobile phones and 400 tablet computers that were together worth HK\$2.2 million. This is a successful example of special operations involving multiple seizures from the same network.

So far this year customs has prevented 18 large smuggling attempts involving at least 500,000 cigarettes in each case, up from 17 such cases all of last year. In addition, China has significant penalties – the maximum penalty for smuggling is a fine of HK\$2 million and imprisonment for seven years, while anyone involved in dealing with, possessing, selling, or buying illicit cigarettes can be punished with a fine of HK\$1 million and a two-year jail term.<sup>86</sup> However, caution should be exercised in interpreting these statistics. In recent years, the number of cases transferred for criminal prosecution dropped 40 percent, with the Guangdong prosecutor's office instructing prosecutors to "cautiously choose whether cases should be brought," and with less serious criminal cases, "postpone enforcement where appropriate."<sup>87</sup>

### **Ireland and the United Kingdom<sup>88</sup>**

Ireland and the United Kingdom (UK) have the highest and second highest cigarette tax in Europe.<sup>89</sup> As a result both countries experience significant smuggling problems and for that reason were selected for inclusion in this report.

In Ireland, fine-cut tobacco for the rolling of cigarettes is stamped. For stamped products, stamps are applied directly to cigarette packs beneath the cellophane wrapper and are applied at the manufacturing or importation level, whereas in the U.S. stamps are applied above the cellophane wrapper. Stamps are supplied on reels and in sheets. Complete reels contain 50,000 stamps sequentially numbered. Sheets are also sequentially numbered and contain 30,000 numbered stamps. In the U.S., rolls are typically sold with a maximum of 30,000 stamps per roll. Stamps may be placed either horizontally on the back or vertically, whereas in the U.S., stamps are only affixed on the bottom of a pack of cigarettes.

When a refund or credit of tax is in order, the trader must show to the satisfaction of the twenty-two commissioners that the tax stamps concerned have been destroyed or are damaged or are unsuitable for the use. Stamps are always to be destroyed under official supervision. By way of contrast at MDOR, witnessing of the destruction is not always required.<sup>90</sup>

An authorized officer of the Revenue Commissioners may at all reasonable times enter the manufacturing premises and may search, investigate, and take such samples of materials, tobacco products, and partially manufactured tobacco products as the officer shall think proper. The officer can also inspect and take copies of or extracts from any books or other documents there found and reasonably believed by the officer to relate to the manufacture of tobacco



products. This provision eludes to the fact that the officer may be able to search areas that are locked or behind closed doors. This differs from the U.S. where agents are asked to obtain search warrants before they may inspect areas that are locked. Any person who resists, obstructs, or impedes an officer of the Revenue Commissioners in the exercise of these powers shall be guilty of an offense and shall be liable on conviction to a penalty of €3,000.<sup>91</sup>

Persons counterfeiting or altering stamps or who knowingly hold sell or deal in such product is guilty of an offence and is liable on summary conviction for a fine of €3,000 and/or a maximum of 12 months imprisonment, or on conviction on indictment to a fine of up to €12,695 and/or a maximum of five years imprisonment.<sup>92</sup>

In Ireland, a pack of 20 cigarettes is €9.50, approximately 76 percent of which is tax. It is estimated that one in four cigarettes smoked is illegal or has been smuggled in by tourists coming back from holidays in duty-free countries. Experts suggest that the high price of cigarettes coupled with lax fines and penalties for tobacco smugglers makes Ireland a magnet for international smuggling crime gangs. A spokesman for the Irish Tobacco Manufacturers Advisory Committee claims that "there is no doubt that Ireland is a target for international crime gangs and that the money they make from illegal tobacco is funding high level criminal activities in Ireland and abroad. Not only is the government losing hundreds of millions a year but they are helping to furnish criminal gangs with €3 million per week from illegal tobacco."<sup>93</sup>

A recent tobacco duty tax increase in October of 2013 caused Retailers Against Smuggling (RAS) to claim that even the small 10 cent increase would benefit criminal gangs and further damage small shops who need footfall to keep the business going.<sup>94</sup> "It makes no sense whatsoever that the government would increase the price of legal products when black market cigarettes are freely available for as little as €123.20. Any gains that the government hopes to make by raising excise will be eroded by customers buying from the black market." Their spokesperson added, "Ireland has one of the highest rates of cigarette smuggling in Europe and the government is trying to deal with that problem by taxing legitimate retailers out of existence." RAS has recently launched 'Smell a Rat', Ireland's first campaign to make the public aware about the dangers of buying illegal cigarettes from illegal street sellers or at markets. The campaign will focus on print and social media as well as mobile van ads. It seeks to warn consumers about the dangers of buying cigarettes from illegal sellers at streets and markets. An RAS spokesperson said, "People might think they're getting a bargain when they buy cheap cigarettes, but the reality is that they're being conned. Illegal cigarettes contain rat droppings, arsenic, and fiberglass and are sold by organized crime gangs who are involved in drug dealing and human trafficking."<sup>95</sup>

To help combat smuggling of illegal cigarettes, a number of customs posts are to receive new X-ray scanning equipment to help in their battle to prevent the illegal importation of contraband goods.<sup>96</sup> Mobile X-rays are also available for deployment at other locations (such as warehouses) as required. These technologies are just one element of a multi-faceted strategy employed by Revenue to tackle smuggling.

The U.K. comes in at a close second with a price of £8 for a pack of cigarettes.<sup>97</sup>

Not surprisingly the U.K. also has a high level of illegal cigarettes tobacco consumed.<sup>98</sup> In the U.K., the Home Affairs Committee is currently investigating why arrests and convictions for tobacco smuggling have fallen in recent years, and why the U.K. Border Force failed to meet its operational targets for seizing illegal tobacco in 2012-13.<sup>99</sup> The committee is also investigating

- whether current sanctions and penalties for tobacco smuggling are appropriate;
- similarities and differences in tobacco smuggling patterns in the U.K. and Ireland;
- the implications of restrictions on the National Crime Agency that prevent it from carrying out police operations or recruiting agents in Northern Ireland; and
- the relationship between tobacco smuggling, organized crime and paramilitary activity.

The Home Affairs Committee invited written evidence to be submitted no later than 12:00 BST on August 29, 2013.<sup>100</sup> Oral testimony is currently underway.<sup>101</sup> In the meantime, the Revenue and Customs Department has said it is committed to tackling tobacco smuggling and has invested an extra £25m from 2010 to 2015.

## **Ukraine<sup>102</sup>**

Sources claim that the Ukraine is the world leader in cigarette smuggling, in large part because the tax rate is lower than surrounding countries.<sup>103</sup> One recent indication of the extent of smuggling in the Ukraine is the discovery, in July 2012, of a smuggling tunnel the length of seven soccer pitches complete with its own train running beneath the border between Slovakia and Ukraine along with more than 2.5 million contraband cigarettes.<sup>104</sup> Police said the tunnel also had possibly been used to smuggle people into Slovakia, an EU member state, from Ukraine, but that its main use had been to illegally import cigarettes into the EU bypassing customs duties. Slovakia shares a 61 mile border with Ukraine, whose remoteness and deep forests mean it is commonly used by smugglers of drugs, cigarettes, and refugees from east to west.<sup>105</sup>

The EU Border Assistance Mission to Moldova and Ukraine named “Ovidius” took place in July 2013.<sup>106</sup> This operation was aimed at improving inter-agency and international cooperation and enhancing border-control measures in order to prevent cross-border crime. “Ovidius” deployed special Task Force Teams to operate at selected seaports, airports, land border crossing points, and inland customs points, and to target specific types of crime. During the operational phase of “Ovidius”, the partners reported

- 116 incidents; seized 100,000 pieces of cigarettes, 19 vehicles, 3,896 liters of alcohol and two weapons;
- 81 people were sanctioned for violations of the border regime; and
- 13 illegal migrants and three facilitators were detained.

Non-declared consumer goods were detected in 10 cases, with the total value of €300,000.<sup>107</sup> This is an example where organizations operating across jurisdictional boundaries can work together to achieve significant results.

The above research was compiled to illustrate and illuminate on problems faced by high-tax countries and innovative practices in the area of compliance and enforcement that are occurring in different parts of the world. In sum, findings include the following:

- There is a movement to adopt plain packaging. While this is being advocated as a way to increase prevention and reduce consumption, some argue that it makes counterfeiting easier.
- A comprehensive approach to address illicit domestic manufacturing involves
  - mandated licensing of its manufacturers;
  - stamps applied at the manufacturing level;
  - closure of manufacturing facility if non-compliant; and
  - implementation of a cradle-to-grave track-and-trace system.
- Higher fines and penalties are not very effective if there is not also a willingness to prosecute.
- Countries with high tax rates have high levels of smuggling of counterfeit stamps, non-stamped product and counterfeit product. Organized crime is heavily involved in these smuggling efforts.
- Organizations within and across jurisdictional boundaries can and are working together very effectively to achieve significant results.

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# Section 8

## Conclusions and Recommendations

Using a variety of techniques, the first 7 sections of the report provide a vast array of information on many aspects of cigarette and other tax products (OTP) tax administration, tax compliance, enforcement, and evasion. All evidence points to the fact that, as a result of the recent tax increases, the Minnesota Department of Revenue (MDOR) can expect increased evasion and noncompliance. What follows are recommendations that will assist MDOR to enforce cigarette and OTP tax law and as a result exert downward pressure on evasion. Where possible revenue and spending estimates are provided.

### Revenue Estimating and Compliance Rates

Minnesota's revenue estimates are solid. However, given other states' experience after increasing other tobacco taxes, MDOR should continue to pay close attention to monthly receipts. In addition, MDOR's estimated compliance rates are either average or above average for products other than non-cigarette products.

### Data Capture/IT Systems

Minnesota should consider mandating electronic filing for returns in 2014. MDOR should also develop a plan to promote available electronic services and any future electronic filing mandate. In the event that mandated electronic filing falls behind schedule, MDOR could explore using electronic data capture (data imaging) of paper returns. Adoption of this technology could reduce the amount of data entry and allow for resources to be allocated to other areas.

Explore increased opportunities for electronic information sharing (exchanging) with other states. Currently 17 states are using the GenTax® tax administration system. This should reduce barriers to information sharing as GenTax® has the ability to capture information and store it in its data warehouse in a format that will facilitate compatible information sharing.

Consider automation of the license application review to automatically check for outstanding balances and open periods.

Introduce a systematic process for background checks for criminal activity. Research the possibility of using the Federal Bureau of Investigations' National Instant Criminal Background Check System or the State Police Criminal History Data Base to determine if an applicant has been convicted of a cigarette or tobacco related crime.

## Returns

Require sub-jobbers and manufacturers to complete and file informational returns. Capture and analyze the information on a regular basis to ensure that the tax has been paid on all products that are handled and sold by manufacturers and sub-jobbers (including products sold to reservation retailers).

## Licensing and Permitting

Consider licensing all stages of the supply and distribution chain for both cigarette and tobacco products. Examples of fees for survey states are found in Appendix H. New licenses could include

- retailers,
- vending machines,
- manufacturers,
- transporter permits to transport cigarettes and tobacco products through the state, and
- requiring manufacturers who ship to distributors or sub-jobbers to hold a license.

Consider increasing the price of all existing license fees and change the price of cigarette and tobacco products sub-jobber license fees to be consistent with the price of distributor license fees.

Minnesota could generate over \$100,000 in additional license revenue if the state would consider increasing existing fees to the survey-state average and also treat cigarette and other tobacco licensing. This figure does not include revenue that could be generated from licensing retailers and manufacturers and introducing transporter permits to transport cigarette and tobacco products through the state.

**Consider a legislative change to provide for arm's length sales transactions and prohibit anyone from obtaining a license if the business has been purchased without an arm's length sales transaction.** Such legislation exists in California and New York. An "arm's length transaction" is defined as a sale in good faith and for valuable consideration that reflects the fair-market value in the open market between two informed and willing parties, neither under any compulsion to participate in the transaction.<sup>108</sup> A sale between relatives or between related companies or partners, or a sale for the primary purpose of avoiding the effect of violations that occurred at the retail location, is presumed not to be made at "arm's length".

## **Stamps**

Write rules and procedures for the return of damaged stamps.

Consider referring automatically to audit when a claim for refund or credit associated with stamp purchases is made.

Change the stamp color and/or design more frequently, as this makes it more difficult to produce counterfeit stamps and, as such, has a positive impact on illegal sales.

Evaluate the feasibility of requiring stamping for tobacco products that do not currently have this requirement. Based on the survey findings and staff interviews, priority should be given to moist snuff and non-stamped cigars.

Conduct a detailed cost-benefit analysis of introducing a high-technology stamp. Three states currently have contracts to purchase such stamps. In recent years, increased competition has occurred in the high-technology stamp market, creating new options and resulting in lower costs. While states are slowly beginning to look at the options for digital tax stamp/indicia solutions, cost continues to appear to be the main reason for limited adoption.

In conducting a cost-benefit analysis, rather than thinking of high technology stamps as a solution in and of itself, MDOR would need to enhance its compliance strategy to include licensing at all levels of the supply and distribution chain, performing more frequent scheduled and unscheduled inspections, and reviewing civil and criminal fines and penalties.

## **Audit/Inspections**

Consider separating the audit and inspection functions. Such specialization could increase work quality and productivity and consider hiring three additional inspectors. The salary for an entry-level audit/inspection staff is \$38,376.

Consider consolidating criminal investigation functions within the inspection area.

Increase resources at a minimum to maintain historic levels of audits and unscheduled inspections (prior to tax increase). These resources are needed to compensate for loss of personnel resources that are being allocated to test the tax administration system.

Because of the recent tax increase, increase the number of scheduled and unscheduled inspections for players at all levels of the supply and distribution chain.

Seek expanded authority to inspect behind locked doors to ensure that contraband product is not being stored in areas that are inaccessible to inspectors. For example, a provision could be added to the statutory licensing requirement that would permit authorized inspectors to access all areas of a licensed business.

To increase efficiency, explore creating a computer program that inspectors can use to enter data into laptops or tablets while in the field.

## **Criminal Investigations**

In light of the recent tax increase, increase the number of criminal investigators assigned to perform cigarette and tobacco investigations. There is only one criminal investigator currently and approximately three to five criminal cases are being presented for prosecution annually. MDOR should review both the quantity of and the types of resources allocated to criminal investigations and develop a strategic plan. For example, in addition to criminal investigators, MDOR should consider making use of data analytics to help make stronger cases for potential prosecution. In addition, consider hiring two more investigators. The salary for an entry-level Revenue Special Investigator is \$46,758.

In light of the possibility of losing access to AFT resources, consider providing dedicated budget funding for equipment.

Consider merging cigarette and OTP criminal investigators into the inspection area.

Establish a working group with participants from other agencies directly or indirectly involved in similar activities such as County Attorneys' General, County Sheriff Departments, the State Attorney General, State Patrol, Minnesota Bureau of Criminal Apprehension, and the federal Bureau of Alcohol, Tobacco, Firearms, and Explosives to improve communication, leverage resources, and increase interagency cooperation with the goal of improving results.

Consider working with individuals at all levels within the judicial system to understand and overcome impediments to prosecute.

## **Youth**

Require vending machine licenses for both cigarette and OTP. Alternatively, consider outlawing vending machine cigarette sales.

Explore partnerships to explore, and work toward, common goals of public health agencies, law enforcement, and MDOR. At a minimum, this would involve regular coordinated enforcement efforts. As noted in Section 5, many of the recommendations for increased compliance and enforcement will have a direct impact on the sale of illegal tobacco to youth.



## Educational Outreach

There are several areas where immediate public outreach should be considered.

- Availability of electronic filing
- Tax implications for e-cigarettes
- What constitutes smuggling
- Tip-line for smuggling

Vehicles through which this education could occur include:

- Website
- Public service announcements
- Income tax informational bulletins
- Bill boards/highway signs
- Retailers

## Proposed Legislative Changes to Consider to Improve Compliance

The following recommendations are derived from Minnesota's existing statutes and survey-state information reported in Section 4.

**Change the definition of tobacco products in Minnesota Statute Chapter 297F.01 (19) to include nicotine:** "Tobacco products" means any product containing, made, or derived from tobacco or containing nicotine that is intended for human consumption, whether chewed, smoked, absorbed, dissolved, inhaled, snorted, sniffed, or ingested by any other means, or any component, part, or accessory of a tobacco product, including, but not limited to, cigars; little cigars; cheroots; stogies; periques; granulated, plug cut, crimp cut, ready rubbed, and other smoking tobacco; snuff; snuff flour; cavendish; plug and twist tobacco; fine-cut and other chewing tobacco; shorts; refuse scraps, clippings, cuttings and sweepings of tobacco, and other kinds and forms of tobacco; but does not include cigarettes as defined in this section. Tobacco products excludes any tobacco product that has been approved by the United States Food and Drug Administration for sale as a tobacco cessation product, as a tobacco dependence product, or for other medical purposes, and is being marketed and sold solely for such an approved purpose.

**Change the definition in Minnesota Statute Chapter 297F.01 (21a). to clarify that an unlicensed seller can be someone that is located within or outside the State of Minnesota:** "Unlicensed seller" means anyone who is located within or outside of the boundaries of the state of Minnesota and is not licensed under section 297F.03 to sell the particular product to the purchaser or possessor of the product.

## Licensing

### **Change Minnesota Statute Chapter 297F.04 (2) License Suspension, Cancellation,**

**Nonrenewal, or Revocation and (2a) cancellation or nonrenewal:** The commissioner must not issue or renew a license under this chapter, and may cancel, suspend, or revoke a license under this chapter, if the applicant or licensee:

- 1) owes \$500 or more in delinquent taxes as defined in section 270C.72, subdivision 2; after demand, has not filed tax returns required by the commissioner;
- 2) had a cigarette or tobacco license revoked by the commissioner within the past two years;
- 3) had a sales and use tax permit revoked by the commissioner within the past two years; or
- 4) has been convicted of a crime involving cigarettes, including but not limited to: selling stolen cigarettes or tobacco products, receiving stolen cigarettes or tobacco products, or involvement in the smuggling of cigarettes or tobacco products.
- 5) has been convicted of a felony
- 6) has been assessed a fraud penalty on any Minnesota tax filing, tax order, or assessment associated with the entity, owners, or officers of the business.
- 7) has removed and sold or processed stamps that have previously been used or affixed to a pack of cigarettes.

(2a) The commissioner may refuse to issue a license, cancel a license, or not renew a license if one of the following conditions occurs:

- 1) the license holder has not filed a cigarette or tobacco products tax return for at least 1 year;
- 2) the license holder has not reported any cigarette or tobacco products tax liability on the license holder's returns for at least 1 year; or
- 3) the license holder requests cancellation of the license.
- 4) has been convicted of a felony
- 5) the applicant or license holder has been assessed a fraud penalty on any Minnesota tax filings associated with the entity, owners, or officers of the business.
- 6) the applicant or license holder has purchased from an unlicensed seller
- 7) the applicant or license holder has removed and sold or processed stamps that have previously been used or affixed to a pack of cigarettes.

## Civil and Criminal Fines and Penalty Changes

**Change Minnesota Statute Chapter 297F.20 (9). Purchases from unlicensed sellers (a). To include imported products:** Purchases from unlicensed sellers (a) No retailer or subjobber shall purchase or import cigarettes or tobacco products from any person who is not licensed under section 297F.03 as a licensed distributor or subjobber.

**Change Minnesota Statute Chapter 297F.21 Contraband (1) (j) to include distributors and subjobbers:** Any cigarette packages or tobacco products offered for sale or held as inventory for which there is not an invoice from a licensed seller, subjobber, distributor, or manufacturer as required under section 297F.13, subdivision 4.

**Change Minnesota Statute Chapter 297F.20 (8) to include suspended or canceled licenses:**

Sales after license revocation. A person selling cigarettes or tobacco products after the person's license has been cancelled, suspended, or revoked is guilty of a felony.

**Change Minnesota Statute Chapter 297F.19 (3) to include a minimum fine for failure to make and file returns:** Penalty for failure to make and file return. If a taxpayer fails to make and file a return within the time prescribed, including an extension, a penalty of five percent of the amount of tax not timely paid is added to the tax however, the penalty shall not be less than \$250 for an unfiled return.

**Change Minnesota Statute Chapter 297F.20 (6) Unstamped Cigarettes; Untaxed Tobacco Products; Contraband, Minnesota Statute Chapter 297F.20 (7) Sales of Cigarette Packs with Indian Stamps, Minnesota Statute Chapter 297F.20 (9) Purchases from Unlicensed Sellers):**

Evaded tax of \$500 or less Imprisonment of not more than 90 days and/or a fine of not more than \$1,000. [Minn. Stat. Sec. 609.52, Subd. 5]

Evaded tax of more than \$500 but not more than \$1,000: Imprisonment of not more than 1 year and/or a fine of not more than \$1,000. [Minn. Stat. Sec. 609.52, Subd. 4]

Evaded tax of more than \$1,000 but not more than \$5,000: Imprisonment of not more than 5 years and/or a fine of not more than \$10,000. [Minn. Stat. Sec. 609.52, Subd. 3(3)]

Evaded tax of more than \$5,000: Imprisonment of not more than ten years and/or a fine of not more than \$20,000. [Minn. Stat. Sec. 609.52, Subd. 3(2)]

Evaded tax of more than \$35,000: Imprisonment of not more than 20 years and/or a fine of not more than \$100,000. [Minn. Stat. Sec. 609.52, Subd. 3(1)].

## **New Civil and Criminal Fines and Penalty**

**Failure to keep records:** This is a civil penalty that is generally imposed when a business fails to keep proper books, records, or invoices. A fine of \$1,000 for each day that the person fails or refuses to allow an audit or inspection of the records [Code of Virginia, Title 18.2 § 18.2-11(b)], [Code of Virginia, § 58.1-1007], [Code of Virginia, § 58.1-1021].

**Failure to keep records:** This is a criminal penalty that is generally imposed when a business fails to keep proper books, records, or invoices. Add a class 2 misdemeanor; up to 6 months in jail. [Code of Virginia, Title 18.2 § 18.2-11(b)], [Code of Virginia, § 58.1-1007], [Code of Virginia, § 58.1-1021]).

### **Refusal to Permit Authorized Examination or Inspection:**

This is a civil penalty that is generally imposed if a business refuses to allow an authorized person to examine or inspect the premises. Adopt legislative change similar to California. \$1,000 for each offense. [California Revenue and Taxation Code, Sections 30471 and 30435] [Business and Professional Code, Section 22980 and 22981].

**Counterfeit Cigarettes/Papers or Gray Market Cigarettes:** Add a new penalty and fine for counterfeit products or gray market cigarettes. Add a felony and imprisonment for not more than five years or payment of a fine of not more than \$10,000, or both. This fine and penalty should be consistent with the counterfeit stamp criminal penalty. [Minn. Stat. 609.03 and Minn. Stat. 297F.20 (4)]

### **Failure to display a license - generally imposed for failure to display a license.**

Adopt legislation similar to California: \$500 penalty for failure to display a license, in addition to any other penalty [California Business and Professions Code, Section 22974.5 (retailer)].

In addition, the Board may impose penalties or sanctions for a variety of offenses or non-compliance with license law provisions from making false statements on an application; failure to maintain 1 year of invoices on the premises, *etc.* For a first offense - sanctions range from the issuance of a warning letter to potential revocation or suspension of the license, second or any subsequent offense, potential license suspension or revocation, or potential civil penalty not to exceed the greater of five times the retail value of the seized cigarettes or tobacco products; or \$5,000 [California Business and Professions Code, Section 22974.7 (Retailers); Section 22978.7(wholesaler or distributor); Section 22979.7 (manufacturer or importer)].

**Operating without a License.** Generally, operating without a license can include someone who has never received a license or someone who is operating on a revoked or suspended license. Create a civil penalty and adopt legislative change based on Iowa but with higher penalties. Minnesota is satisfied with their criminal penalty. First violation \$1000, second violation within three years, \$2000, and third or subsequent violation within three years, \$5000. [Iowa Code 453A.31 (1) (b)]

**Penalty for Operating without a Vending Machine License:** This penalty is generally imposed for failure to display a vending machine license or decal. If a new licensing requirement is adopted to license individual vending machines, create a penalty and include both cigarette and other tobacco products when someone operates a vending machine without a license. [N.J. REV. Stat. 54:40A-32.1 and 54:40A-50]

**Create new civil penalties for possession or delivery of Unstamped Cigarettes; Untaxed Tobacco Products:** Adopt legislative change similar to Iowa. [Iowa Code 453A.31 (1) (a) and 453A.11]

First violation

1. Flat penalty of \$200 for more than 200 but not more than 400 unstamped cigarettes
2. Flat penalty of \$500 for \$50 - \$200 value of untaxed OTP.
3. Flat penalty of \$500 for more than 400 but not more than 2000 unstamped cigarettes.
4. Per pack penalty of \$25 applies if there are more than 2000 unstamped cigarettes.
5. Flat penalty of \$1,000 for \$200+ value of untaxed OTP or 150% of the value of the untaxed OTP; whichever is greater.

Second violation in three years –

1. Flat penalty of \$400 for more than 200 but not more than 400 unstamped cigarettes.
2. Flat penalty of \$1,000 for \$50 - \$200 value of untaxed OTP.
3. Flat penalty of \$1,000 for more than 400 but not more than 2000 unstamped cigarettes.
4. Per pack penalty of \$35 applies if there are more than 2000 unstamped cigarettes.
5. Flat penalty of \$2,000 for \$200+ value of untaxed OTP or 200% of the value of the untaxed OTP; whichever is greater.

For a third or subsequent violation within three years –

1. Flat penalty of \$600 for more than 200 but not more than 400 unstamped cigarettes.
2. Flat penalty of \$2,000 for \$50 - \$200 value of untaxed OTP.
3. Flat penalty of \$1,500 for more than 400 but not more than 2000 unstamped cigarettes.
4. Per pack penalty of \$45 for more than 2000 unstamped cigarettes.
5. Flat penalty of \$4,000 for \$200+ value of untaxed OTP or 250% of the value of the untaxed OTP; whichever is greater.

## Other Fines and Penalties

**Alteration or Removal and Reuse of a Tax Stamp:** Adopt legislative change similar to Virginia. [Code of Virginia, § 58.1-1015(A) and (B)].

This is penalty is generally imposed when someone removes and sells or possesses stamps that have previously been used or affixed to a pack of cigarettes.

First offense - removes or otherwise prepares stamp with intent to use, or buys, sells, offers for sale, or gives away washed or removed or restored stamps or possesses any washed or restored or removed or altered stamp; reusing stamp; manufactures, buys, sells, offers for sale, or possesses any reproduction or counterfeit stamps provided for in this article, or whoever sells any stamps not affixed to taxable cigarettes - up to \$5,000 and license revocation.

**Possession or Sale of Counterfeit Stamps:** This penalty is generally assessed when someone possesses or sells counterfeit stamps. Adopt legislative change similar to Virginia. [Code of Virginia § 58.1-1015(D)]

First offense - 40 or more stamps, up to \$2,000. Second of subsequent offense - 40 or more stamps, up to \$50,000 and, if applicable, the revocation by the Department of Taxation of the wholesale dealers license.

**Civil Penalty for Selling Gray Market Cigarettes:** This is a civil penalty that is generally imposed when cigarettes not intend to be sold, distributed, or used in the U.S. are sold, distributed, or used in the United States. Adopt legislative change similar to Virginia. [Code of Virginia, § 58.1-1035 (B)]

A civil penalty in not to exceed the greater of 500 percent of the retail value of the cigarettes involved or \$5,000.

**Reimbursement of Investigation and Prosecution Costs:** In general, this fee is charged as a way for the department to recoup some of the cost associated with an investigation or prosecution of anyone who has violated the provisions of the law. Adopt legislative change similar to Iowa. [Iowa Code, §453A.30]

If taxes have not been paid or reports not filed, as required, the department shall assess against the permit holder or other person, as additional penalty, the reasonable expenses and costs of the investigation and audit.

**Failure to Keep Records:** This penalty is generally imposed when a business fails to keep proper invoices, books, or records. Adopt legislative change similar to Virginia. [Code of Virginia, § 58.1-1007].

\$1,000 for each day that the person fails or refuses to allow an audit or inspection of the records.

**False Statement on an Application for License:** Generally imposed when someone provides false information on an application for a license or a permit. Adopt legislative change similar to Virginia. [Code of Virginia, Title 18.2 § 18.2-11(a)] [Code of Virginia, § 58.1-1011]

Anyone who knowingly and willfully falsifies, conceals or misrepresents a material fact or knowingly and willfully makes a false, fictitious or fraudulent statement or representation in any application for a stamping permit to the department shall be guilty of a Class 1 misdemeanor - up to 1 year in jail up to \$2,500, either or both.

**Altering or Counterfeiting a License:** This criminal charge is generally imposed when a person makes, purchases, or assists in making or purchasing false, counterfeit, or altered licenses, certificate stickers, vending machine discs, or markers, or when a person is in possession of a device used to forge, alter, or counterfeit a license, vending machine disc, or marker. Adopt legislative change similar to Michigan. [MCL 205.428 (7)]

A felony punishable by a fine of not more than \$5,000 or imprisonment for not more than 5 years, or both.

**Purchasing Stamps, not from Department:** This criminal penalty is generally imposed when a person purchases or uses revenue tax stamps from anyone other than the department. Adopt legislative change similar to Virginia. [Code of Virginia, Title 18.2 § 18.2-10(f)]; [Code of Virginia, § 58.1-1009]

Any person who purchases revenue stamps from anyone other than the department, or who uses or affixes, or causes to be used or affixed, any revenue stamps not purchased from the department by the owner of the cigarettes being handled or stamped, whether such stamps are genuine or counterfeit, shall be guilty of a Class 6 felony, 1-5 years imprisonment, or in the discretion of the jury or court trying the case without a jury, up to 12 months, fine up to \$2,500, or both.

## **Generating Revenue to Help Defray Costs**

Consider increasing certain license fees. This could generate over \$100,000 annually.

Consider introducing new licenses. It is not possible to quantify annual fee revenue because these activities are not currently licensed.

Any additional revenue arising from changes in licensing could be used to help defray the cost of increased inspections, particularly unscheduled inspections of distributors, sub-jobbers, and manufacturers.

## **Miscellaneous**

Work to expand coverage of the Prevent All Cigarette Trafficking (PACT) Act to all tobacco products.



# Appendix A

## Consulting Team

JD Michael LLC, a tax consulting firm, was founded in 2003 by five professionals who previously worked as Senior Managers for the Illinois Department of Revenue. Bios for the members of the JD Michael consulting team are below.

### ***DR. NATALIE A. DAVILA***

#### **PROFESSIONAL PROFILE**

For 15 years Dr. Davila has participated on a daily basis in the formulation and execution of data-driven tax and economic development policies. She has extensive experience in developing methodologies, gathering relevant data, analyzing and making recommendations on state tax issues including but not limited to individual income, corporate income, sales, cigarette and tobacco products, liquor, gaming, and lottery taxes. Natalie also has significant experience in the design, administration and analysis of survey, case study and focus group research. Dr. Davila was the Research Director for the Illinois Department of Revenue from 2003 to 2013.

### ***TERRY L. CRUMLY***

#### **PROFESSIONAL PROFILE**

Ms. Crumly has over thirty years of work experience with the Illinois Department of Revenue (IDOR) in program and project management, legislative proposal development and analysis, and technical sales and excise tax advice. In 1998 she was appointed to serve as the Manager of the Excise Taxes Division. She possesses extensive knowledge of the laws, functionality, and processes of the taxes she administered. Terry was frequently asked to consult on cigarette and tobacco issues with other states, countries, and federal agencies as well as industry representatives. Ms. Crumly served as the Lt. Governor and Governor of the Federation of Tax Administrators (FTA) Tobacco Tax Section Central Region from 1999 to 2001. She then went on to serve on the Executive Board as Secretary, and became the Chair person from 2007 to 2008. She has received many certificates of recognition, awards, and nominations from the Illinois Department of Revenue and the FTA Tobacco Tax Section for her work.

In August of 2011 she became the first recipient of the FTA Tobacco Tax Section Charles Mills Lifetime Achievement Award.

## ***VIRGINIA D. BARTLETTI***

### **PROFESSIONAL PROFILE**

Ms. Bartletti has over thirty-two years of work experience with the Illinois Department of Revenue, rising from entry level clerical responsibilities to analyzing and communicating tax law (including cigarette and tobacco tax law) to the public. With her comprehensive experience and knowledge Virginia brings to the table valuable knowledge in all aspect of processing tax returns and the needs of all divisions and the taxpayer. She is considered an expert in process development and reengineering.

Virginia's efforts in streamlining tax processes have resulted in her receiving commendations from the Governor and Secretary of State of Illinois.

## ***JEANNE L. BLOOM***

### **PROFESSIONAL PROFILE**

Ms. Bloom has over twenty years of business financial analysis, program/policy evaluation, project management, and survey experience. She designed a survey instrument and conducted the City of Chicago's Enterprise Zone and Real Estate Tax Incentive Programs evaluation study to determine the use of City incentive programs and the effectiveness of the programs. In addition, Jeanne has designed and managed several database projects. As the City's liaison with the Center for Urban Economic Development, Ms. Bloom worked on refining the database variables of the cost-benefit model used for estimating city tax revenues and expenditures of specific projects, provided the project numbers for analysis, and created the final reports. In addition, Jeanne is a Certified Genealogist<sup>SM</sup>.

## ***KARA L. MORETTO***

### **PROFESSIONAL PROFILE**

Ms. Moretto has extensive expertise in tax administration and policy analysis. Over a period of 23 years, Kara has developed extensive knowledge in local tax allocation of revenues and the legislative process and related issues. During her last seven years at the Illinois Department of Revenue, Ms. Moretto administered the property tax and advised stakeholders in property tax policy formulation. She has strong research and analytical skills.

## ***CYNTHIA J. WILEY***

### **PROFESSIONAL PROFILE**

Thirty years of experience with the Illinois Department of Revenue processing returns, analyzing legislation, creating forms and publications, and technical writing and editing for various audiences such as legislators and the general public. Served the last 19 years as a manager of tax professionals responsible for communicating tax law and policies to the public.

# Appendix B

## Tobacco Tax Collection Report

### Subdivision 1. Report to legislature.

- a) The commissioner of revenue shall report to the 2014 legislature on the tobacco tax collection system, including recommendations to improve compliance under the excise tax for both cigarettes and OTP. The purpose of the report is to provide information and guidance to the legislature on improvements to the tobacco tax collection system to:
  - (1) provide a unified system of collecting both the cigarette and other tobacco
  - (2) taxes, regardless of category, size, or shape, that ensures the highest reasonable rates of tax collection;
  - (3) discourage tax evasion; and
  - (4) help to prevent illegal sale of tobacco products, which may make these products more accessible to youth.
  
- (b) In the report, the commissioner shall:
  - (1) provide a detailed review of the present excise tax collection and compliance system as it applies to both cigarettes and OTP. This must include an assessment of the levels of compliance for each category of products and the effect of the stamping requirement on compliance for each category of products and the effect of the stamping requirement on compliance rates for cigarettes relative to other tobacco products. It also must identify any weaknesses in the system;
  - (2) survey the methods of collection and enforcement used by other states or nations, including identifying and discussing emerging best practices that ensure tracking of both cigarettes and other tobacco products and result in the highest rates of tax collection and compliance. These best practices must consider high-technology alternatives, such as use of bar codes, radio-frequency identification tags, or similar mechanisms for tracking compliance;
  - (3) evaluate the adequacy and effectiveness of the existing penalties and other sanctions for noncompliance;
  - (4) evaluate the adequacy of the resources allocated by the state to enforce the tobacco tax and prevention laws; and
  - (5) make recommendations on implementation of a comprehensive tobacco tax collection system for MDOR that can be implemented by January 1, 2015, including:
    - (i) recommendations on the specific steps needed to institute and implement the new system, including estimates of the state's costs of doing so and any additional personnel requirements;
    - (ii) recommendations on methods to recover the cost of implementing the system from the industry;

(iii) evaluation of the extent to which the proposed system is sufficiently flexible and adaptable to adjust to modifications in the construction, packaging, formatting, and marketing of tobacco products by the industry; and  
(iv) recommendations to modify existing penalties or to impose new penalties or other sanctions to ensure compliance with the system.

# Appendix C

## Existing Process Overview and Detailed Analysis

What follows is a detailed review of Minnesota Department of Revenue's (MDOR) present excise tax collection and compliance system as it applies to both cigarettes and other tobacco products (OTP). The assessment was developed by subject matter experts with fifty years of combined experience in cigarette and tobacco sales and excise tax administration from information gathered during a three-day site visit to MDOR. Information contained in this appendix is current as of September 2013.

### Licensing

#### Licensing Overview

##### *Distributors and sub-jobbers*

Minnesota statutes require that all distributors and sub-jobbers, including those located outside Minnesota, apply for and obtain a license before they can sell or distribute cigarettes or other tobacco products in Minnesota. Anyone that wishes to obtain a license must first complete Form CT100, License Application for Cigarette Distributors and Sub-Jobbers, or Form CT101, License Application for Tobacco Distributors and Sub-Jobbers. License applications are available on MDOR's website but have to be completed manually.

The fee for a cigarette distributor license is \$300. The fee for any other tobacco distributor license is \$75. Each license is valid for a two-year period beginning January 1 of each even-numbered year and ending December 31 of the following odd-numbered year. Half-rate fees are available if an application for a license is being made in the second year. A separate application is required for each type of license and for each location.

Surety bonds are required for cigarette distributor licensees but not for other businesses within the supply chain. The bond may be in the form of a corporate surety bond or a certified check and must be in an amount suitable to guarantee payment of the tax stamps purchased by a distributor. Bonds may also be required if a cigarette distributor is delinquent in the filing of any cigarette tax return or is delinquent in the payment of any uncontested cigarette tax liability. If a bond is required it must remain in effect for at least a period of two years.

A separate sub-jobber's license is required for each place of business (other than the licensed cigarette distributor location if the distributor has made application for both types of licenses). The fee for a cigarette sub-jobber license is \$24. The fee for other tobacco sub-jobber license is \$20.

All licenses must be displayed prominently at the location indicated, cannot be transferred to another person or business, and may be revoked or suspended for any violation of any act applicable to the sales of cigarettes or OTP.

The commissioner may refuse to issue a license if the applicant

- owes \$500 or more in delinquent taxes;
- after demand, has not filed tax returns required by the commissioner;
- had a cigarette or tobacco license revoked by the commissioner within the past 2 years;
- had a sales and use tax permit revoked by the commissioner within the past 2 years; or
- has been convicted of a crime involving, including but not limited to,
  - selling stolen cigarettes or tobacco products,
  - receiving stolen cigarettes or tobacco products, or
  - smuggling of cigarettes or tobacco products.

The commissioner may cancel or not renew a license if the license holder

- has not filed a cigarette or OTP tax return for at least 1 year,
- has not reported any cigarette or OTP tax liability on the tax returns for at least 1 year; or
- requests cancellation of the license.

For fiscal year 2013 the number of licensees in circulation is as follows:

**Table B-1 Number of Licenses in Minnesota**

	<b>Cigarette</b>	<b>OTP</b>
<b>Distributors</b>	12	160
<b>Sub-jobbers</b>	40	24
<b>Non-resident distributors</b>	38	98
<b>Non-resident sub-jobbers</b>	4	2

**Retailers**

Although some cities and counties have a license requirement for retailers who sell cigarettes or other tobacco products, the state does not have a retail cigarette or tobacco licensing requirement. Estimates indicate there are roughly between 4,500 to 5,000 retailers that sell cigarettes or tobacco products.

**Manufacturers**

Minnesota does not have a licensing requirement for manufacturers or manufacturer representatives.

## Licensing Detail

Applications for a license are received in the Mail Processing Unit. They are sent to a special postal code (3331) which allows them to be sorted quickly for delivery to the Special Taxes Division. All mail is stamped with the date it was received. Applications received without a payment are given to the Mail Receiving Unit for delivery to the Systems, Training, and Communications (STC) Unit. Mail received with a payment is given to the Payment Processing Imaging (PPI) Unit in the Tax Operations Division.

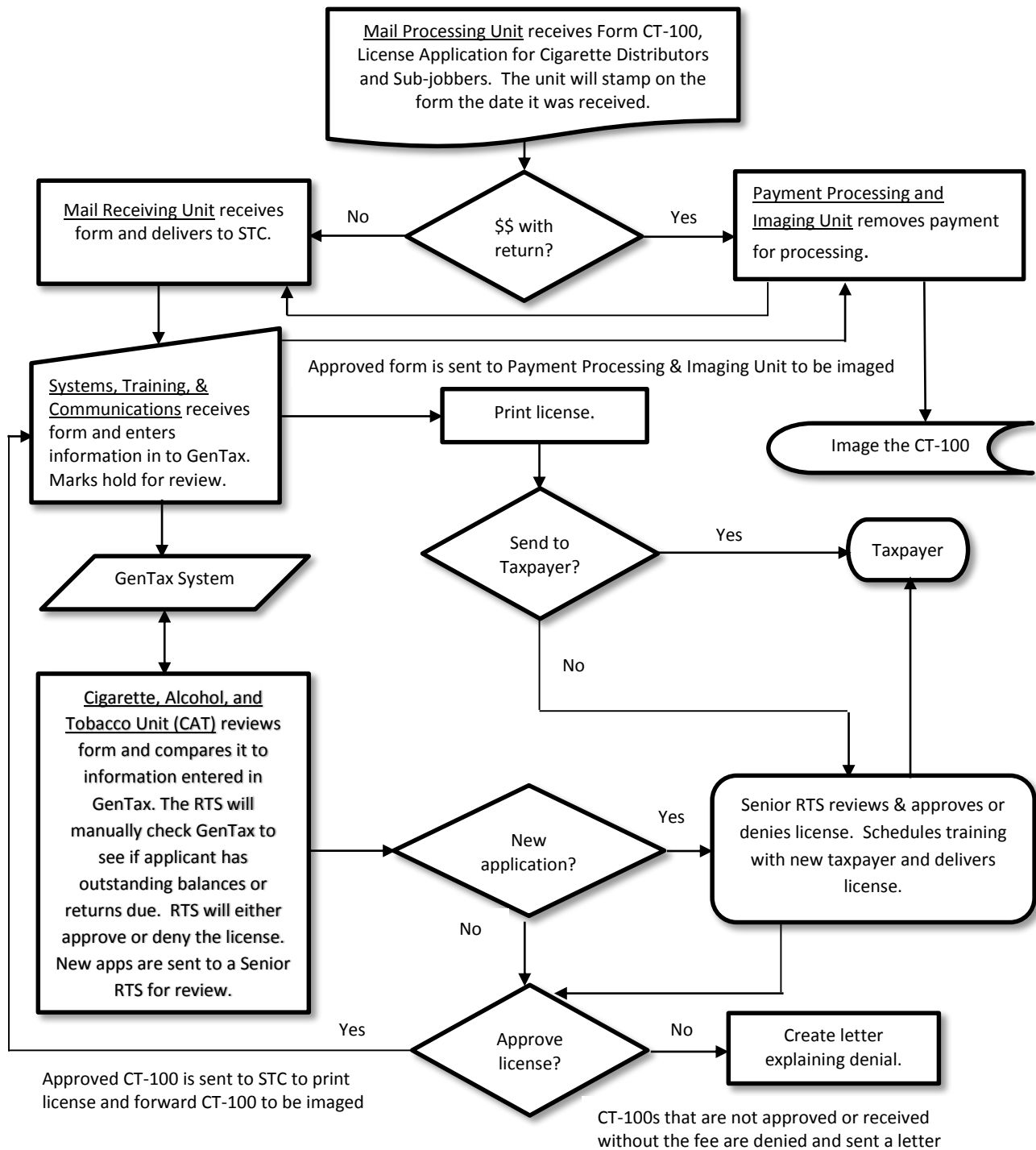
The Payment Processing and Imaging Unit processes and images any payment received with an application. Once the payment is processed, the Payment Processing and Imaging Unit sends the application to the Systems, Training, and Communications (STC) Unit within the Special Taxes Division. When it arrives in this unit, the information on the application is entered into MDOR's main computer system (GenTax®). The entry work is performed by an office administrative specialist senior. All license applications are entered into GenTax®. If a license is denied, a record of the application and the reason it was denied is officially recorded.

Applications are then forwarded to the Cigarette, Alcohol, and Tobacco (CAT) Unit and must be reviewed by an RTS before a license can be mailed to a taxpayer. The RTS checks the information in the GenTax® System to make sure it is consistent with information contained in the paper copy of the application. Also, the RTS verifies that all requirements have been met and that the taxpayer has filed all returns and has paid or is in the process of paying any outstanding tax liabilities. If an application is denied, a letter of explanation for the denial is sent to the applicant, any application fee will be refunded, and the account will be closed. If the license application is for a new license rather than a renewal of a current license, the application must be reviewed by a senior RTS.

All new applicants receive on-site training and assistance with tax returns and are instructed on compliance matters.

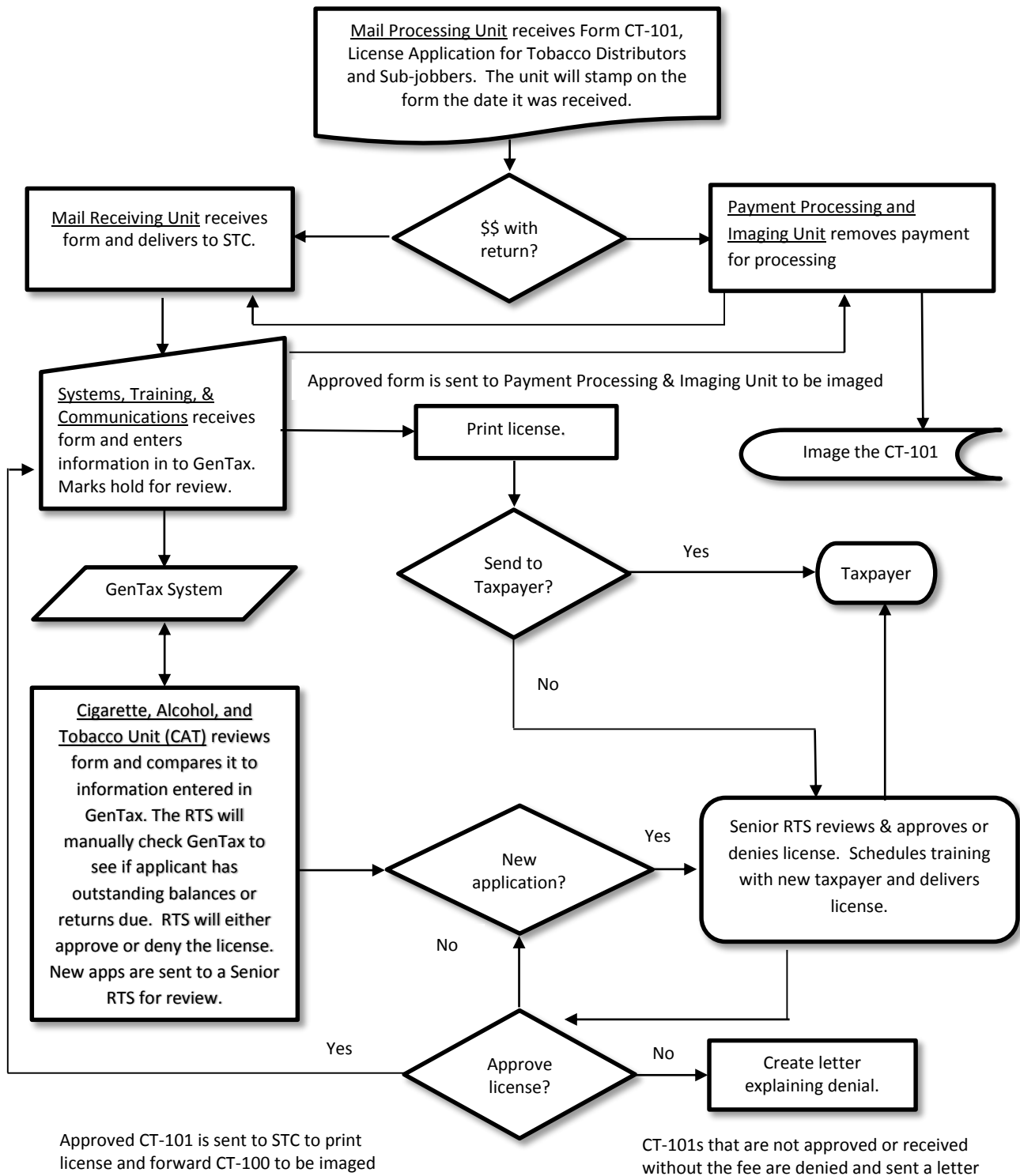
After a license has been approved by an RTS or senior RTS, the application is returned to the STC Unit. This unit prints a license and either mails it to the taxpayer or gives it to a senior RTS for delivery when the on-site training is scheduled. This unit also sends the application back to the PPI Unit to image the license application.

**Chart B-1 Licensing Process for Cigarette Distributors and Sub-jobbers**





**Chart B-2 Licensing Process for Tobacco Distributors and Sub-jobbers**



## Findings from Review and Assessment of Licensing Process

- Data lifting or electronic filing is not available for applications for a license.
- The cigarette and tobacco license applications are manually reviewed to check for outstanding balances and open periods.
- The statute requires that those applying for a cigarette or tobacco license should be checked for cigarette and tobacco related crimes. A formal method or procedure is not in place to determine whether or not an applicant has been convicted of a cigarette or tobacco-related crime.
- The commissioner may require a corporate surety bond or a certified check in an amount suitable to guarantee payment of the tax stamps purchased by a distributor. Bonds only may be required for cigarette tax stampers and are only required when a distributor is delinquent in the filing of any cigarette or tobacco return, or if the distributor is delinquent in the payment of any uncontested cigarette or tobacco tax liability.
- Manufacturer and Manufacturer Representative Licenses are not authorized.
- Licensing stickers are not required on cigarette or tobacco vending machines.
- Retailer licensing occurs at the city or county level. MDOR is not always notified when licenses are issued.
- The license fee for sub-jobbers differs significantly from the fee for distributors. The sub-jobber license is \$24 every two years for cigarette and \$20 for tobacco. This compares to the distributor license fee of \$300 every two years for cigarette and \$75 for OTP.
- The statute currently does not have a provision for an arm's length sales transaction to prevent individuals from conducting illegal activity, leaving the county, and selling the business to a relative.
- Minnesota does not have a provision in the statute that provides for revocation of other types of licenses and permits held by retailers who violate provisions of the cigarette and tobacco tax statutes.

## Cigarette Stamping

### Cigarette Stamping Overview

All distributors who sell cigarettes in Minnesota for retail sale must affix a cigarette stamp on each package to indicate that the Minnesota cigarette excise tax was paid. Distributors place stamp orders with MDOR and can select either standard or overnight shipping. Distributors pay the tax value of the stamps ordered, as well as a fee to cover the cost incurred to produce the stamp, when they file their returns.

There are two different types of stamps — stamps for cigarette packages sold on Native American reservations and stamps for all other cigarette packages sold in Minnesota. MDOR has a print contract with a company which manufactures both stamps.

Stamps are sold in the following quantities:

*Non-Native American*

- Rolls containing 30,000 stamps for packs of cigarettes containing 20 cigarettes
- Pads containing 1,500 stamps for packs of cigarettes containing 20 cigarettes
- Wide pads containing 1,500 stamps for packs of cigarettes containing 20 cigarettes
- Rolls containing 7,200 stamps for packs of cigarettes containing 25 cigarettes
- Pads containing 1,500 stamps for packs of cigarettes containing 25 cigarettes

*Native American*

- Rolls containing 30,000 stamps for packs of cigarettes containing 20 cigarettes
- Pads containing 1,500 stamps for packs of cigarettes containing 20 cigarettes
- Pads containing 1,500 stamps for packs of cigarettes containing 25 cigarettes

Stamps sales for 2013 were as follows:

**Table B-2 Number of Stamps Issued**

	<b>Non-Native Americans</b>	<b>Native Americans</b>
<b>Packs of 20 cigarettes</b>	227,200,500	4,636,500
<b>Packs of 25 cigarettes</b>	34,200	1,500

### **Cigarette Stamp Processing Detail**

An assigned Revenue Tax Specialist (RTS) monitors the stamp inventory and places an order as needed. Stamps are stored in a locked vault at all times. When stamp shipments are received, the cigarette stamp types, serial numbers, and quantities are entered into the Inventory Manager portion of the tax administration computer system (GenTax®). The Cigarette, Alcohol, and Tobacco Unit uses the Inventory Manager in GenTax® to track cigarette stamp inventory and create invoices for cigarette stamp orders. The invoices and details are associated directly with the taxpayer's account. Duties include

- entering new inventory into the system,
- removing inventory from the system when it is sold or adding it back when stamps are returned, and
- shipping inventory.

Within the unit, there is a separation of duties for the cigarette stamp inventory process for security reasons. Two employees enter new inventory into the system (one main person and the backup). These employees do not have the security rights to remove inventory from or add inventory back into the system. They also are not allowed to package and ship stamp orders. Several other employees have rights to remove inventory from and add inventory back into the system, but they do not have the security rights to enter new inventory. Also, these employees are not allowed to package and ship stamp orders. The remaining employees can package and ship stamp orders, but cannot enter or remove inventory from the system.

## Findings from Review and Assessment of Stamping Process

- Minnesota did not change the stamp color or design when the recent tax increase went into effect.

## Tax Returns

### Tax Returns Overview

All cigarette and other tobacco tax returns and payments are due on the 18th day of the month following the end of the reporting month. A return must be filed even if there is no tax liability for that month. If the return is filed late (or the payment is missing), the filer will be billed a *late-payment penalty* which is 5 percent of the unpaid tax for each 30 days the payment is late (or any part of 30 days) up to 15 percent. If the return is filed late, the filer will also be billed a *late-filing penalty*. This penalty is 5 percent of the unpaid tax. The maximum penalty for both paying and filing late is 20 percent. If the filer knowingly files a false or fraudulent return, or intentionally does not file to avoid paying tax, criminal penalties may also apply. Interest is charged on the unpaid tax plus penalties from the date the tax was due until it is paid in full.

All businesses must keep complete and accurate records at each licensed location, including

- itemized invoices of cigarettes or tobacco products held, purchased, manufactured, brought in, or caused to be brought in from outside Minnesota, or shipped or transported to retailers in Minnesota; and
- sales of cigarettes made, except sales to the ultimate consumer.

Electronic payments are required if the distributor owes \$10,000 or more in tax during the last 12-month period ending on or before June 30. A penalty may be assessed for failure to pay electronically. The penalty is 5 percent of each payment that should have been remitted electronically, but was remitted by some other means. Electronic payments can be made by logging into the MDOR's website and selecting e-Services, or calling a toll-free pay-by-phone number.

The current cigarette tax effective July 1, 2013, is 141.5 mills per cigarette or \$2.83 per standard pack of 20 cigarettes plus \$.493 sales tax for a total of \$3.323. The combined tax is \$4.15 for a pack of 25 cigarettes. The combined tax rate is \$3.823 per pack of 20 cigarettes on non-settlement brands (includes sales tax plus \$0.50 per pack non-settlement fee). In addition, effective July 1, 2013, the tax rate for cigarettes weighing more than three pounds per thousand is 283 mills or \$5.66 per pack plus a sales tax of \$0.493 for a total of \$6.153 and \$6.653 for non-settlement brands (includes sales tax plus \$0.50 per pack non-settlement fee). The non-settlement fee effective July 1, 2013, is \$0.0175 per cigarette.

The Minnesota tax does not apply to

- federally exempt cigarettes,
- quantities of 200 or fewer transported into the state by a consumer, and
- sales to the masters of ocean-going vessels for use aboard ships outside the continental limits of the U.S. provided the cigarettes are also exempt from the taxes imposed on cigarettes by the U.S. government.

The current tobacco tax effective July 1, 2013, is 95 percent of the wholesale sales price with the following exceptions:

- Premium cigars — the excise tax on premium cigars is \$3.50 per cigar or 95 percent of the wholesale sales price, whichever is less.
- Little cigars — these are now taxed as cigarettes.
- Moist snuff — the excise tax on moist snuff is 95 percent of the wholesale sales price through December 31, 2013.

The tax does not apply to the possession, use, or storage of tobacco products if

- the tobacco products have an aggregate cost in any calendar month to the consumer of \$50 or less and
- the tobacco products were carried into this state by that consumer.

## Tax Returns Processing Detail

The following is a list of forms and schedules.

**Table B-3 Cigarette Forms**

<u>Minnesota Distributors</u>	
CT201	Cigarette Tax Monthly Return
CT201-A	Unstamped/Other-State Stamped Cigarettes Received During the Month
CT201-B	Credit for Returned Cigarettes
CT201-C	Out-of-State Cigarette Sales
CT201-F	Monthly Cigarette Fee
CT201-I	Cigarette Inventory
CT201-N	Cigarette Sales on Native Reservations
CT201-R	Cigarette Reconciliation
CT201-S	Minnesota Stamped Cigarettes Received During the Month
<u>Nonresident Distributors</u>	
CT401	Cigarette Tax Monthly Return
CT401-B	Credit for Returned Cigarettes
CT401-C	Minnesota Cigarette Sales
CT401-F	Monthly Cigarette Fee
CT401-I	Cigarette Inventory
CT401-N	Cigarette Sales on Native Reservations

CT401-R	Cigarette Reconciliation
<u>Importers</u>	
CT501-A	Cigarettes Imported During the Month
CT501-C	Unstamped Cigarette Sales to Minnesota Distributors
CT501-D	Out-of-State Cigarette Sales
CT501-I	Cigarette Inventory
CT501-R	Cigarette Reconciliation
<u>Miscellaneous</u>	
CSB	Cigarette Surety Bond
CT109A	Distributor Affidavit (Application for credit memo for damaged cigarette tax stamps)
CT211	Cigarette Stamp Order Form
CT601	Cigarette and Tobacco Audit (for Minnesota sub-jobbers)
CT601-I	Cigarette Inventory (for Minnesota sub-jobbers)

**Table B-4 Tobacco Forms**

CT301	Tobacco Tax Monthly Return
CT301-A	Purchases of Tobacco Products
CT301-B	Credit for Tobacco Products
CT301-C	Tobacco Sales in Other States
CT301-N	Tobacco Sales on Native Reservations
CT601	Cigarette and Tobacco Audit (for Minnesota sub-jobbers)

When returns arrive in the Data Capture Unit, the information on the returns and schedules is entered into the GenTax® system. The data-entry work is performed by an office administrative specialist. The returns are then sent to the Payment Processing and Imaging Unit to be scanned.

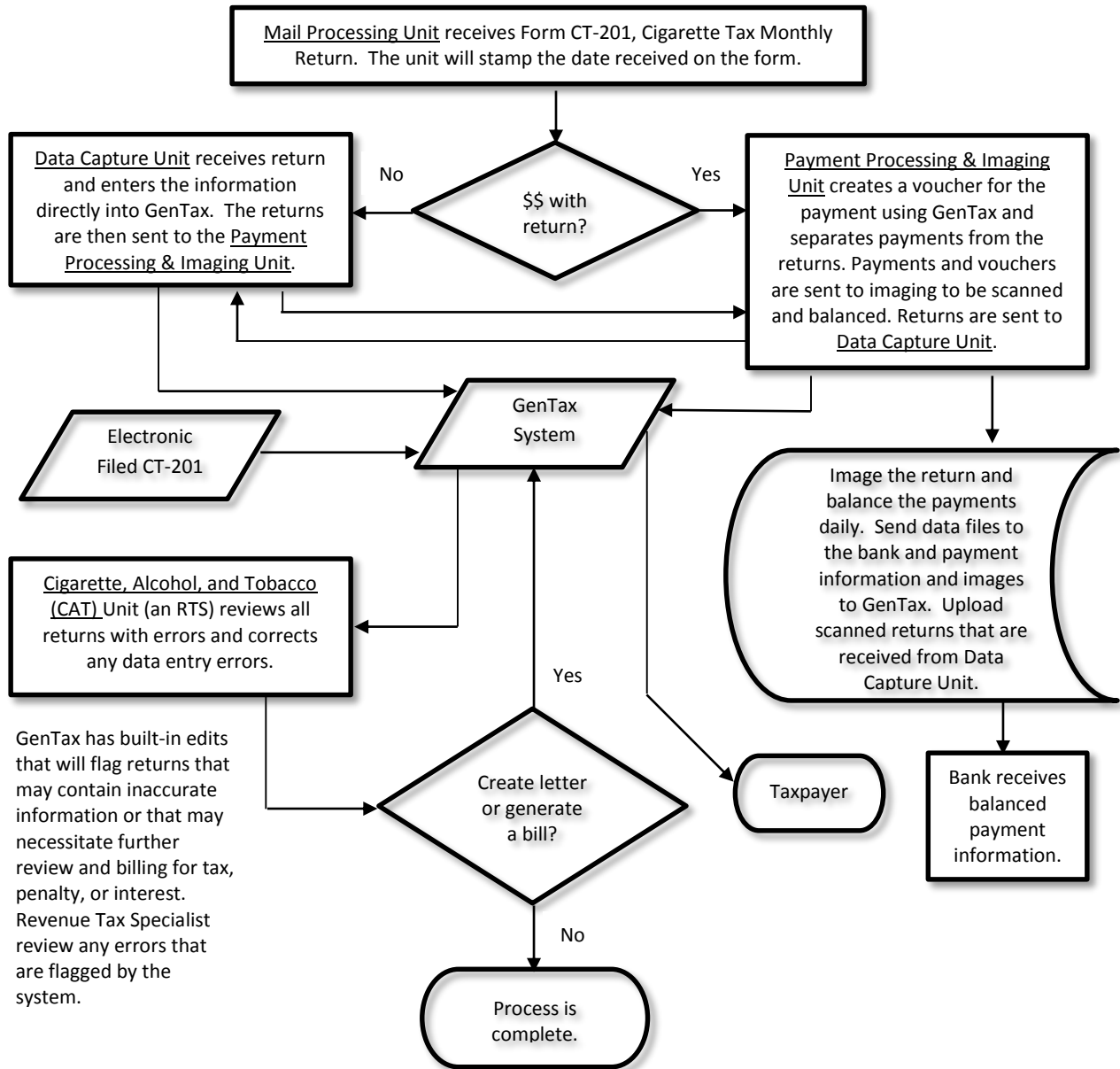
Returns that are filed and fully paid on time and pass all pre-determined tests require no further action and the processing is complete. Returns that are not filed or fully paid on time will cause the GenTax® system to generate a bill to the taxpayer (provided there are no errors on the return). These bills then become part of the collection process.

Returns that do not pass all tests are flagged for review. This review is performed by an RTS. The RTS checks the information in the GenTax® System against an image of the paper return to ensure that there are no data entry errors. The RTS fixes any data entry errors and reviews the returns for missing information or schedules. The RTS has the option of sending a letter to the taxpayer in an attempt to rectify any problems with the return.

## **Findings from Review and Assessment of the Tax Returns Process**

- Data on paper returns is entered manually.
- A limited number of businesses are utilizing cigarette and tobacco electronic filing services.
- MDOR does not have a mandatory electronic filing program
- Implementation of the recent tax changes resulted in approximately 50 percent of the cigarette and tobacco returns being flagged for review.
- While MDOR requires distributors to complete and file informational returns, the department does not require sub-jobbers to complete and file comparable information.
- As a result of implementing the recent tax changes, RTS resources in the Cigarette, Alcohol, and Tobacco Unit have been moved away from inspections and audits to performing suspense correction.
- The CT201-C Schedule which contains information on shipments of products to locations outside the state is currently not being captured and stored in GenTax®.

**Chart B-3 Flow of Cigarette Tax Monthly Returns**





# Inspections Process

## Inspections Process Overview

MDOR staff have pen readers which they take to an inspection to help identify counterfeit stamps. They also have cell phones and cameras. Vehicles used for non-criminal, unscheduled retail inspections are marked vehicles that contain state identification.

Once on site, the inspector asks to see the cigarette and tobacco retail license issued by the county or city and begins to complete the Business Information section of the Retail Inspection Report (Form CT105). The inspector asks to see the invoices for the last few months. The invoices are checked against the Cigarette/Tobacco Distributors report to verify that the retailer is purchasing the products from a distributor or sub-jobber licensed to sell cigarette and tobacco products in Minnesota. Any invoices that are reviewed, along with the purchase dates and the supplier names, are recorded in the Retail Inspection Report.

The inspector uses the pen reader to verify the stamps on the cigarette packs in the racks are authentic. Packs that have been checked have the stamp number and price of the brand recorded in the inspection report. The inspector also randomly opens a few unopened cartons to ensure they are properly stamped.

The inspector identifies contraband tobacco products by checking the manufacture dates against the product date codes and invoices. Products that are checked along with the product price are recorded on Form CT105. If the inspector finds the retailer to be in compliance, the clerk is thanked for his time and told he is in compliance. If contraband product is seized, Form M21, Notice of Seizure of Contraband, must be completed and includes the following product information:

- Quantity of packages/and or cartons
- Size of cartons and or packages
- Brand
- Brand flavor

The clerk must print and sign his name on the M21.

The Criminal Investigation Division (CID) then is notified that product was seized and that the product needs to be stored in the humidor. A seizure notice is sent to the licensing authority to notify them that contraband was seized from the retailer. A copy of the seizure report accompanies the notice. Referrals to the CID are made when the estimated value of seized contraband is \$300 or more.

If products are unstamped or there are issues with the stamping, the product distributor is contacted for corrective action. The distributor must send a letter to show that corrective action was taken.

Contraband products can be destroyed 75 days after the contraband products were seized if the taxpayer doesn't file a demand for a judicial determination. If cigarettes were seized because the Fire Safe Cigarette (FSC) label was absent, the Minnesota State Fire Marshal is notified.

For vending machine inspections, stamped cigarette packages must be visible from the face of the machine. If the vending machine is in a retail location, the business must have a cigarette retail license. However, most vending machines are located in bars. The vending machine owner must have a sub-jobber license issued by the MDOR. If the sub-jobber's name isn't on the vending machine, an employee at the retail location should be able to provide the sub-jobber's name.

It is not uncommon to come across bars and liquor stores that sell cigarettes which they purchased from a convenience store. This can be determined by asking to see the distributor invoice. When this situation arises, the inspector does not have to seize the cigarettes if they are stamped but uses the opportunity to educate the retailer that all cigarette and tobacco products must be purchased from a licensed distributor.

When retail inspections are performed, one out of ten retailers have some type of violation.

### **Findings from Review and Assessment of the Inspection Process**

- The number of non-scheduled retail, distributor, and sub-jobber inspections has been negatively impacted because a significant portion of staff time has been reallocated to testing the GenTax® system.
- Inspections behind locked doors require the permission of the owner or sales clerk.
- Inspectors have to manually create paper reports for their inspections and reenter the information into GenTax®.

### **Criminal Investigations Overview**

Investigators in the Criminal Investigations Division open a case when someone from the CAT Unit seizes contraband product, when someone makes a referral, or when someone contacts the tip hot line. Most cases are opened as a result of referrals from the CAT unit.

### **Criminal Investigations Detail**

When a case is opened, the investigator interviews witnesses and subjects of the criminal investigations to gather evidence of tax evasion or criminal activity. If necessary, the investigator prepares subpoenas or search warrants to produce evidence of the crime. After a crime has been established the investigator turns over all materials to the county attorneys for prosecution. Three to five such cases are presented annually. If needed, the investigator testifies in court or appears as a witness for the prosecution. If the court orders that restitution be made, MDOR's Criminal Investigation Division is responsible for handling all restitution payments.

## **Findings from Review and Assessment of the Criminal Investigations**

- Only one criminal investigator is assigned to perform cigarette and tobacco investigations for the state of Minnesota and only about three to five criminal cases are presented a year.

## **Audits**

### **Audits Overview**

Cigarette and tobacco tax audits are conducted by the Cigarette, Alcohol, and Tobacco (CAT) Unit. There are eleven auditors who perform audits on cigarette and tobacco returns. Accounts may be randomly selected for audit, or specifically selected by an auditor based on retail inspections or information that an auditor has uncovered. All in-state accounts are audited every 18 months.

## **Collections**

### **Collections Overview**

The Collection Division is responsible for collecting delinquent state taxes and taking legal action to ensure that all taxpayers fulfill their state tax obligations. Tax notices are generated by a processing unit or automatically generated by the computer system based on set criteria. After a tax notice has been mailed to a taxpayer, the Collection Division becomes responsible for collecting the taxpayers' outstanding liability. Depending on the level of the complexity of the particular case, all collection officers can handle any cigarette or tobacco case. The Collection Division can request voluntary payment of taxpayers' delinquent taxes by calling, writing, or in-person contact the taxpayers. Collection officers can initiate liens, levies, and payment plans to collect delinquent taxes that have not been paid voluntarily.

Collection officers identify taxpayers' assets and income sources to initiate the most effective collection actions by verifying employment, bank accounts, and other pertinent information with taxpayers' employers, bankers, landlords, *etc.* They also can conduct routine on-site investigations to discover assets by observing individual and business activities through personal visits and examination of third-party records.

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# Appendix D

## Organizational Unit Overview

Information contained in this appendix is current as of September 2013, the month the site visit was made.

### Processing Areas

#### Mail Processing Unit Overview

**Division:** Tax Operations  
**Supervisor:** Sheila Barnes, Office Services Supervisor 2  
**Summary of Activities:** This unit receives on average 10,000 pieces of mail per day. Mail is sorted in this unit. All cigarette and tobacco related correspondence has a postal code of 3331 which allows the mail to be sorted quickly and directed to the Mail Receiving Unit for delivery to the appropriate areas. All mail is stamped with the date it was received. Envelopes are not retained.  
**Inputs:** Unopened mail  
**Outputs:** Opened and sorted mail  
**Material Used:** General office supplies  
**Technologies Used:** Automated mail extraction equipment  
**Important Time Factors:** Mail must be opened quickly and accurately to facilitate payment and document processing.  
**Potential Weaknesses:** No major potential weaknesses noted for this area. The supervisor utilizes seasonal employees during peak processing times to ensure prompt processing. However, it should be noted that if MDOR promoted the use of electronic filing and electronic payment, this unit would see a reduction in inventory.  
**Special Job Demands:** N/A  
**Headcount:** 16 full-time employees (seasonal employees are also used)

Job Titles	Number
Central Services Administrative Spec .Intermediate	1
Office and Administrative Specialist	1
Office Specialist	14

### **Mail Receiving Unit Overview**

**Division:** Tax Operations  
**Supervisor:** Peggy Meszaros, Office Services Supervisor 2  
**Summary of Activities:** This unit is responsible for the physical delivery of the mail to the various locations in the agency. In addition, this unit is responsible for mailing letters, notices, and packages from the MDOR to outside parties.  
**Inputs:** Letters, notices and packages that need to be mailed  
**Outputs:** Mail that is ready to be sent to outside parties  
**Material Used:** General office supplies  
**Technologies Used:** N/A  
**Important Time Factors:** Mail must be delivered quickly and accurately to facilitate payment and document processing.  
**Potential Weaknesses:** No major potential weaknesses noted for this area. The supervisor utilizes seasonal employees during peak processing times to ensure prompt processing. However, it should be noted that if MDOR promoted the use of electronic filing and electronic payment, this unit would see a reduction in inventory.  
**Special Job Demands:** N/A  
**Headcount:** 8 full time employees (Seasonal employees are also used)

<b>Job Titles</b>	<b>Number</b>
Central Services Administrative Specialist Senior	1
Office Specialist	3
Office and Administrative Specialist Intermediate	1
Central Services Administrative Specialist	2
Office and Administrative Specialist	1

### **Payment Processing and Scanning Unit Overview**

**Division:** Tax Operations  
**Supervisor:** Amy Crowder, Office & Administrative Specialist Sr.  
**Summary of Activities:** This unit is split into three sub groups; payments, remittance, and scanning. The payments group receives all of the Cigarette and Tobacco payments that are attached to a return (they are kept together). Employees in this unit create a voucher using the GenTax® System. Voucher information is based on the received date that is stamped on the return. Payments are then separated from the returns and paired up with their vouchers and delivered to the scanning room. The returns are delivered to the Data Entry Unit. In the scanning room, the remittance group scans the payments and vouchers. The remittance group balances all payments daily. All payments are processed within MDOR, the data files are sent to the bank, and the payment images and information are uploaded into the

GenTax® System. The retention period for payments is approximately 3 to 6 months. Electronic payments are mandated for cigarette and tobacco taxpayers that have a liability of \$10,000 or more during a fiscal year ending June 30. Payments can be made via wire transfer, credit card, debit card, ACH credit, ACH debit, cash, account credit, checks, and money orders. Most payments are made using some type of electronic method. The scanning group receives the cigarette and tobacco returns from the Data Entry Unit. These returns are scanned and the images are uploaded and attached to the taxpayer accounts in the GenTax® System. **Note:** GenTax® has built-in edits that flag returns that may contain inaccurate information that may necessitate further review and billing for tax, penalty, or interest.

**Inputs:** Payments  
**Outputs:** An accurate record of tax return payment information  
**Material Used:** General office supplies  
**Technologies Used:** GenTax® and electronic payment processing methods  
**Important Time Factors:** Information must be data entered quickly and accurately to facilitate payment and document processing.  
**Potential Weaknesses:** It should be noted that if MDOR promoted the use of electronic filing and electronic payment, this unit would see a reduction in inventory.  
**Special Job Demands:** N/A  
**Headcount:** 20 full time employees

Job Titles	Number
Revenue Collections Officer 2	1
Office and Administrative Specialist Senior	3
Office and Administrative Specialist Intermediate	10
Office Specialist	6

**Data Capture Unit Overview**

**Division:** Tax Operations  
**Supervisor:** Nicole Anderson, (Acting) Office and Administrative Specialist Senior  
**Summary of Activities:** All cigarette and tobacco returns are manually data entered directly into the GenTax® System by Office Administrative Specialists. Applications for a license must be sent to the Systems, Training, and Communications (STC) Unit and are manually data entered directly into the GenTax® System by an Office Administrator Specialist Senior. **Note:** Data lifting is not used on these returns at this time. Electronic filing is not mandated at this time.  
**Inputs:** Tax return data  
**Outputs:** An accurate record of tax return information  
**Material Used:** General office supplies

**Technologies Used:** GenTax® System  
**Important Time Factors:** Information must be data entered quickly and accurately to facilitate payment and document processing.  
**Potential Weaknesses:** Data lifting is not used on paper returns at this time. Data lifting would reduce the resources needed to capture return information. It should also be noted that if MDOR promoted the use of electronic filing and electronic payment, this unit would see a reduction in inventory.  
**Special Job Demands:** N/A  
**Headcount:** 15 full time employees

Job Titles	Number
Office and Administrative Specialist	15

**Early Audit 1 Business and Special Taxes Unit Overview**

**Division:** Tax Operations  
**Supervisor:** Devanie Hoven, Revenue Tax Supervisor 3  
**Summary of Activities:** After the information on tax returns has been captured, the information is ran through a series of pre-determined tests. Returns that do not pass all tests are flagged for review. This review is performed by a Revenue Tax Specialist (RTS). The RTS checks the information that is now located on the GenTax® System against an image of the paper return and manually checks to ensure that there are no data entry errors. The RTS fixes any data entry errors. The RTS also reviews the returns for missing information or schedules and has the option of sending a letter to the taxpayer in an attempt to rectify any problems with the return. The returns can be accepted with errors and passed on for further Audit review.  
**Inputs:** Missing return data.  
**Outputs:** An accurate record of tax return and payment information. Notices of additional tax liability.  
**Material Used:** Tax return information located in the GenTax® system  
**Technologies Used:** GenTax® System  
**Important Time Factors:** Documents must be reviewed, perfected, and processed to facilitate any billing of unpaid liabilities. Bills must be issued within statutory time frames.  
**Potential Weaknesses:** Data lifting is not used on paper returns at this time. Data lifting would reduce the resources needed to capture return information. It should also be noted that if MDOR promoted the use of electronic filing and electronic payment, this unit would see a reduction in inventory. This unit is currently not performing these duties for cigarette and tobacco tax returns. This work is being performed in the Cigarette, Alcohol, and Tobacco (CAT) Unit.



**Special Job Demands:** N/A  
**Headcount:** 12 full time employees

<b>Job Titles</b>	<b>Number</b>
Revenue Tax Specialist Senior	1
Revenue Tax Specialist Intermediate	2
Revenue Tax Specialist	5
Revenue Examiner	2
Office and Administrative Specialist Senior	1

**System, Training, and Communications Unit Overview**

**Division:** Special Taxes  
**Supervisor:** Renee Bernier/ Glen Kleven  
**Summary of Activities:** The office and administrative personnel within this unit receive cigarette and tobacco license applications for new licenses and enter information from the application into the GenTax® System. After the information is added to the GenTax® System the applications are forwarded to a Senior Revenue Tax Specialist (auditor) within the Cigarette, Alcohol, and Tobacco (CAT) Unit of the Special Taxes Division and they perform a final review and determine whether or not to issue a license. The STC unit receives the applications back from the CAT unit after final reviews are complete. Administrative personnel within the STC unit print the licenses and either mail the license to the applicant or give the license to an auditor who will deliver the license to the applicant. In addition, the STC Unit processes stamp order requests and fills stamp orders for shipment or pickups. Any returns that this unit receives either by fax or mail are categorized and sent to Tax Operations for processing.

**Inputs:** Data from license applications  
**Outputs:** Cigarette and tobacco products licenses; completed cigarette tax stamp orders.  
**Material Used:** License applications received from taxpayers and invoice orders for cigarette tax stamps.  
**Technologies Used:** GenTax® System  
**Important Time Factors:** License applications must be processed quickly to allow a business to become operational.  
**Potential Weaknesses:** Data lifting is not used on paper returns at this time. Data lifting would reduce the resources needed to capture return information. It should also be noted that if MDOR promoted the use of electronic filing and electronic payment, this unit would see a reduction in inventory. Data lifting or electronic filing is not available for applications for a license. These applications are manually data entered directly into the GenTax® System.

**Special Job Demands:** N/A  
**Headcount:** 12 full time employees

<b>Job Titles</b>	<b>Number</b>
Project Consultant Senior	1
Management Analyst 4	4
Management Analyst 3	3
Revenue Tax Specialist Principal	1
Office and Administrative Specialist Senior	1
Office and Administrative Specialist Intermediate	2

**Cigarette, Alcohol, and Tobacco Unit Overview**

**Division:** Special Taxes

**Supervisor:** Dan Hughes

**Summary of Activities:** Staff in the CAT Unit serves as the subject matter experts in the administration of the Cigarette and Tobacco excise tax type. This unit is responsible for approving or denying cigarette and tobacco licenses for distributors and sub-jobbers. The RTSs in this unit manually check the GenTax® System to determine whether or not an applicant has an outstanding account balance or has not filed all required returns. The RTSs also determine whether or not an applicant has been convicted of a cigarette-related or tobacco-related felony. This unit conducts training meetings of all new cigarette and tobacco applicants. This unit conducts cigarette and tobacco tax returns and supporting schedules reviews and processes the monthly tax returns. This unit also writes letters to taxpayers and generates bills for outstanding tax, penalty, and interest that may be due. This unit assists with taxpayer's inquiries concerning the processing of returns and with any potential edit errors related to originally processed returns. This unit performs detail cigarette and tobacco audits that cover many months and even years. This unit conducts retail inspections that involve visiting the location of retailers, inspecting their books and records, and checking the inventory. If no one has a clear answer for a particular issue related to the cigarette and tobacco types, it is sent to this unit for handling. GenTax® has built in edits that flag returns that may contain inaccurate information that may necessitate further review and billing for tax, penalty, or interest. Revenue Tax Specialist review any errors that are flagged by the system.

**Inputs:** Entry into GenTax® - Missing taxpayer information and comment regarding the account.

**Outputs:** An accurate record of tax return filing and payment information.  
Notices of additional tax liability.

**Material Used:** Tax return information located in the GenTax® system

**Technologies Used:** GenTax® System

**Important Time Factors:** Documents must be reviewed, perfected and processed to facilitate any billing of unpaid liabilities. Audits must be performed within statutory time frames.

**Potential Weaknesses:** Electronic filing is not mandated at this time. Electronic filing would reduce the amount of items that would have to be reviewed by the RTS and would free up more time for auditing and retail inspections. Senior Revenue Tax Specialists test GenTax® updates taking valuable resources away from performing audits and retail inspections. In addition, these RTSs are performing suspense correction instead of auditing. Marked vehicles are used for retail inspections and sting operations. Data lifting or electronic filing is not available for applications for a license. These applications are manually data entered directly into the GenTax® System. RTSs are used to create and modify tax forms design. The RTSs in this unit manually check the GenTax® System to determine whether or not an applicant has an outstanding account balance or has not filed all required returns. Sub-jobbers are not required to file informational returns.

**Special Job Demands:** Travel

**Headcount:** 14 full time employees

<b>Job Titles</b>	<b>Number</b>
Revenue Tax Specialist Principal	1
Revenue Tax Specialist Senior	5
Revenue Tax Specialist Intermediate	5
Revenue Tax Specialist	3

**Collections Unit Overview**

**Division:** Collection

**Supervisor:** Multiple units

**Summary of Activities:** The Collection Division is responsible for collecting delinquent state taxes and taking legal action to ensure that all taxpayers fulfill their state tax obligation. Tax notices are generated by a processing unit or automatically generated by the computer system based on set criteria. After a tax notice has been mailed to a taxpayer, the Collection Division becomes responsible for collecting the taxpayers' outstanding liability. Depending on the level of the complexity of the particular case, all Collection Officers can handle any cigarette or tobacco cases. The Collection Division can request voluntary payment of taxpayers' delinquent taxes by calling, writing, or in-person contact with the taxpayer. Collection officers can initiate liens,

levies, and payment plans to collect delinquent taxes that have not been voluntarily paid. Collection Officers identify taxpayers' asset and income sources to initiate the most effective collection actions by verifying employment, bank accounts, and other pertinent information with taxpayers' employers, bankers, landlords, etc. They can also conduct routine on-site investigations to discover assets not apparent from file information by observing individual and business activities through personal visits and examination of third-party records. MDOR does not hire any collection positions lower than the Collector 2 level. All cases range from a simple straight forward case that a Collection Officer 2 would handle in which the employee would receive a great deal of oversight to a very complex case that is handled, for the most part, independently by the lead worker, a Revenue Collection Officer 5.

**Inputs:** Additional taxpayer information.  
**Outputs:** Additional notices, payment plans, liens  
**Material Used:** General office supplies  
**Technologies Used:** GenTax® System  
**Important Time Factors:** N/A  
**Potential Weaknesses:** None noted  
**Special Job Demands:** Travel  
**Headcount:** 335 full time employees

<b>Job Titles</b>	<b>Number</b>
Revenue Collection Officer 5	14
Revenue Collection Officer 4	49
Revenue Collection Officer 2 and 3	258
Revenue Collection Officer 1	14

### **Criminal Investigations Overview**

**Division:** Criminal Investigations  
**Supervisor:** John Cannefax  
**Summary of Activities:** Investigators in the Criminal Investigations Division open a case when someone from the Cigarette, Alcohol, and Tobacco (CAT) Unit seizes contraband product, someone makes a referral, or when someone contacts the tip hotline. Most cases are opened as a result of referrals from CAT. There are no special funds available for undercover operations and more criminal investigators are needed to assist with or perform retail inspections and undercover operations. When a case has been opened the investigator interviews witnesses and subjects of the criminal investigation to gather evidence of tax evasion or criminal activity. If necessary, the investigator prepares subpoenas or search warrants to produce evidence of the crime. The

criminal investigators are not sworn officers and they would like law enforcement to take a more active role. After a crime has been established the investigator turns over all materials to the county attorneys for prosecution. Only about 3 to 5 cases are presented a year. If needed, the investigator also testifies in court, or appears as a witness for MDOR in criminal prosecutions. Investigators have indicated that they would like to see higher fines and more jail time for individuals that are being prosecuted. If the court orders that restitution be made, the Criminal Investigation Division is responsible for handling all restitution payments.

**Inputs:** Taxpayer information  
**Outputs:** Subpoenas, search warrants, evidence reports  
**Material Used:** General office supplies  
**Technologies Used:** GenTax® System  
**Important Time Factors:** Statutes of limitation  
**Potential Weaknesses:** There is only one employee that works cigarette and tobacco cases  
**Special Job Demands:** Travel  
**Headcount:** 12 full time employees (2 are on leave and 1 transferred to another agency)

<b>Job Titles</b>	<b>Number</b>
Revenue Special Investigator 2	7
Revenue Special Investigator 1	5

## Job Descriptions

### **Office Specialist — (salary range of \$13.38 - \$17.33 per hour)**

Performs a variety of administrative work supporting customer service, central services, and office and administrative services. Requires general supervision.

- Performs a wide range of office support functions.
- Sorts and distributes mail.
- Weighs mail and places correct postage on letters and packages.
- Directs callers and visitors to the appropriate person(s) and/or writes down messages.
- Enters data into data bases.
- Stocks shelves in store room and issues supplies as requested.
- Types memos and letters.
- Files and retrieves documents from manual and automated filing systems.

Knowledge of:

- Typing/word processing sufficient to type letters and memos
- Data entry
- General office practices
- Alphabetical and numerical filing practices sufficient to file and retrieve documents/information

Ability to:

- Use human relations skills to interact with others (common courtesy, tact, interest in positive problem solving, empathy, and logical organization of ideas).
- Understand and effectively carry out oral and written instructions.
- Handle physical tasks such as lifting, moving materials, and retrieving materials for some positions.

### **Office and Administrative Specialist — (salary range of \$13.95 - \$18.27 per hour)**

Administrative support work providing a variety of office services. Requires general supervision.

- Processes and maintains a variety of fiscal and program records, written materials and reports using general knowledge of program operations and procedures. Employees in this class may also account for receipts and disbursement of money for standard accounts. Some positions may require specialized skills such as key boarding.
- Responds orally and in writing to routine/general inquires based on knowledge of previous situations and often using established formats.
- Types and edits materials using knowledge of procedures to determine the proper format, questions the author if something is obviously missing or is incorrect. This may require knowledge of specialized terminology.

- Assembles and sends application materials, attachments, and other forms based knowledge of standard procedures.
- Codes, records, matches, posts, tallies, verifies, and corrects data in order to maintain accurate financial and accounting records, administrative records, and mailing lists.
- Maintains automated and manual record systems for production, personnel, and/or budget systems.
- Collects and exchanges information and responds to questions from internal customers (agency employees that receive incumbent's services) by personal contact, phone, or e-mail.

Knowledge of:

- Record keeping systems sufficient to maintain administrative and fiscal data and to prepare reports
- Agency or program regulations and procedures sufficient to answer routine questions.
- General office practices
- Business English, spelling, and grammar sufficient to proofread materials and to ensure the accuracy and completeness of written materials
- General office equipment and procedures such as basic math, typing, data entry and related functions

Ability to:

- Work constructively with other employees and customers.
- Organize and prioritize one's own work.
- Organize ideas and information into logical written documents and reports.
- Maintain the confidentiality of private information according to laws, rules, policies, and procedures.

**Office and Administrative Specialist Intermediate (salary range of \$14.94 - \$19.80 per hour)**

Performs administrative support work providing a variety of office services. General supervision required.

- Compiles, reviews, and maintains a variety of fiscal and program records, written materials, and reports using multiple procedures, typing, computer, and technical program knowledge. Maintains special data bases, mailing lists, and manuals. Writes general correspondence. Provides technical advice to other office staff.
- Prepares written and oral replies on a wide range of subjects. Responses are often non-routine and explain procedures and the rationale for decisions.
- Processes applications for services based on procedural knowledge of a specific program.
- Gathers, verifies, and summarizes data for fiscal and administrative reports.
- Prepares complex schedules using specialized software.

- Prepares consultant contracts and internal requisitions and pays consultants, special speakers and vendors according to established procedures.
- Prepares packets of information for special committees, customers, and staff.
- Provides internal customers (agency employees that receive incumbent's services) with information, assistance, and services. Issues may require explanations of somewhat complicated procedures and/or cover multiple program areas.
- Schedules, trains, and gives technical guidance to co-workers.

Knowledge of:

- Program procedures sufficient to prepare correspondence, reports and informational packets
- Record keeping systems sufficient to maintain administrative and fiscal data and to prepare reports
- General office equipment and procedures such as basic math, typing, data entry, and related functions
- Business English, spelling, grammar, and typing sufficient to type and edit a variety of written documents
- General office practices
- Special computer software for some positions
- Legal, medical, and/or other technical terminology for some positions

Ability to:

- Use good human relations skills to interact with others (common courtesy, tact, interest in positive problem solving, empathy, and logical organization of ideas).
- Research a variety of topics and summarize information into clear and concise correspondence and reports.
- Type a variety of letters, forms, accounting and financial statements, and reports.
- Maintain the confidentiality of private information according to law, rules, policies, and procedures.
- Organize and prioritize one's own work.
- Understand and apply oral and written instructions.

**Office and Administrative Specialist Senior (salary range or \$15.99 - \$21.63 per hour)**

Performs administrative support work providing a variety of office services. At this level employees are responsible for an administrative area that typically supports a complex program. Seniors are delegated authority to administer the key support activities. The program area and supporting administrative tasks can be complicated because of their broad scope, multiple and sometime ambiguous procedures and rules, and/or technical depth. Seniors initiate a wide range of activities to ensure that services and program deadlines are met according to established guidelines, rules and statutes. Employees research and respond to issues that may have no immediate solutions within established procedures and guidelines. They may also



direct the work of other staff, students etc. to ensure that the program area is supported.  
General supervision required.

- Approves applications for services where decisions require incumbents to apply their knowledge of specialized program guidelines, select relevant data among multiple variables and research situations that fall outside of existing procedures.
- Prepares agendas and information packets for meetings and seminars.
- Reviews and selects mail to independently research and answer for program and/or executive staff.
- Develops, implements, and maintains office procedures and work systems to resolve existing problems or to respond to new systems or policies.
- Develops internal deadlines for submission of paper work, completion of daily work, and completion of special assignments.
- Prepares and maintains budget, payroll, procurement, human resources, and other record systems to ensure accuracy of data and conformance with statutes and policies.
- Collects and analyzes data for fiscal and administrative reports; adjusts and corrects errors to avoid potential data problems.
- Provides internal customers (agency employees that receive incumbents' services) with information, assistance, and services. Issues are often complicated, varied, and at times controversial. Final answers and resolutions of problems frequently require research and repeated discussions/interviews with customers.
- Trains co-workers, student employees, *etc.*, in specific tasks and procedures to improve and maintain performance levels.
- Provides work direction and technical assistance to other staff, students, volunteers, residents, and/or inmates.

Knowledge of:

- Program guidelines sufficient to establish procedures and deadlines; prepare correspondence and fiscal and administrative reports
- Business English, spelling, grammar and typing sufficient to edit and compose a variety of documents
- Office practices and equipment sufficient to develop and improve work procedures and forms
- Principles and practices of office management sufficient to plan, assign, and review the work of other staff
- General office equipment and procedures such as basic math, typing, data entry and related functions
- Special computer software for some positions
- Legal, medical and/or other technical terminology for some positions

Ability to:

- Use good human relations skills to interact with others (common courtesy, tact, interest in positive problem solving, empathy, and logical organization of ideas).
- Analyze a variety of data, select relevant information, and integrate data into meaningful responses and reports.
- Research a variety of topics and summarize information into clear and concise correspondence and reports.
- Understand and carry out oral and written instructions.
- Establish and maintain complex record systems based on substantial program knowledge.
- Organize and prioritize one's own and others' work.
- Type a variety of letters, forms, accounting and financial statements, and reports.

**Central Services Administrative Specialist (salary range of \$13.95 - \$18.27 per hour)**

Performs administrative work providing general inventory/stores or mail services. (Employees in this class spend at least 60 percent of their time doing inventory/stores or mail work.

At this level the employee works under clearly defines processes or receives assistance from higher level inventory/stores or mail staff.

- Takes inventory, maintains stock records, and prepares reports showing supplies received and issued.
- Stocks shelves and distributes supplies to agency staff.
- Sorts and distributes incoming federal and state incoming mail. Sorts and prepares all outgoing federal and state mail.
- Collects and exchanges information and responds to questions from internal customers (agency employees who receive incumbent's services) by phone, in-person, or e-mail.
- Prepares requisitions and purchase orders for approval.
- Trains, provides technical assistance and work direction to students, inmates, volunteers, and/or residents.

Knowledge of:

- Record keeping systems sufficient to record inventory and supplies that are received and issued
- General office practices
- Federal and state postal regulations sufficient to process all types of mail
- Inventory and stores practices
- General mail and/or stores equipment
- Basic math sufficient to calculate and record mail/inventory data

Ability to:

- Use good human relations skills to interact with others (common courtesy, tact, interest in positive problem solving, empathy, and logical organization of ideas).
- Understand and effectively carry out oral and written directions.
- Handle physical tasks such as lifting, moving materials, stacking, and retrieving materials.

**Central Services Administrative Specialist Intermediate (salary range of \$14.94 - \$19.80 per hour)**

Administrative work providing general inventory/stores or mail services. (Employees in this class spend at least 60 percent of their time doing inventory/stores or mail work. At this level, employees are required to understand and assimilate information from multiple procedures to arrive at practical solutions to problems. Requires general supervision.

- Maintains complete and accurate inventory records of materials, supplies, and equipment using inventory software.
- Receives, stores, issues and ships supplies, materials, and equipment.
- Approves requisitions and purchase orders up to a designated dollar amount.
- Sorts and distributes incoming federal and state incoming mail. Sorts and prepares all outgoing federal and state mail.
- Coordinates special mailing projects.
- Determines the most cost effective mailing and delivery methods.
- Establishes deadlines and modifies mailing procedures to meet deadlines and improve the mail room's efficiency.
- Trains, provides technical assistance and work direction to co-workers, students, inmates, residents, and/or volunteers.
- Collects and exchanges information and responds to questions from internal customers (agency employees who receive incumbent's services) by phone, in-person, or e-mail. Sometimes it's necessary to explain complicated procedures and resolve conflicts.

Knowledge of:

- Automated and manual record keeping systems sufficient to record inventory and supplies that are received and issued
- Purchasing procedures sufficient to write specifications and bids
- Personal computers and software sufficient to enter data, do inquiries and produce reports
- Inventory and stores practices
- Warehouse equipment
- Federal and state postal regulations sufficient to process all types of mail

Ability to:

- Use good human relations skills to interact with others (common courtesy, tact, interest in positive problem solving, empathy, and logical organization of ideas).
- Understand and effectively carry out oral and written directions.
- Give technical advice and work instructions to others in a positive and effective manner.
- Organize and plan work to meet regulations and deadlines.
- Handle physical tasks such as lifting, moving materials and supplies, stacking and retrieving materials.
- Understand and apply oral and written work instructions.

**Central Services Administrative Specialist Senior (salary range of \$15.99 - \$21.63 per hour)**

Performs administrative work providing general inventory/stores or mail services. (Employees in this class spend at least 60 percent of their time doing inventory/stores or mail work. At this level, employees typically establish work priorities and deadlines and develop and modify procedures. Services provided at the senior level are complicated by such factors as volume, diversity, and the need for unique services and/or materials. Seniors determine inventory levels and when and what needs to be ordered and may also determine prices. General supervision is required.

- Develops and modifies procedures to improve the efficiency of operations.
- Trains, provides technical assistance and work direction to other employees, volunteers, students, *etc.*
- Balances and resolves discrepancies in inventory operations.
- Determines when to order materials, supplies, and equipment and may determine prices.
- Maintains complete and accurate inventory records of materials, supplies, and equipment using inventory software.
- Develops new distribution lists.
- Receives, stores, issues, and ships supplies, materials, and equipment.
- Approves requisitions and purchase orders.
- Establishes mail room procedures.
- Establishes deadlines and adjusts work assignments and staffing levels to meet deadlines.
- Collects and exchanges information and responds to questions from internal customers (agency employees who receive incumbent's services) by phone, in-person, or e-mail. Sometimes it's necessary to explain complicated procedures and resolve conflicts.

Knowledge of:

- Office management practices sufficient to establish deadlines, design work flow, and assign work so that services are provided in a cost effective and efficient manner.
- Agency operations and services sufficient to determine inventory levels, diversity of supplies, or unique mail services.

- Automated and manual record keeping systems sufficient to record inventory and supplies that are received and issued.
- Purchasing procedures sufficient to write specifications and bids.
- Personal computers and software sufficient to enter data, do inquiries, and produce reports.
- Inventory and stores practices.
- Warehouse equipment to ensure safe operation.
- Federal and state postal regulations sufficient to process all types of mail.

Ability to:

- Use good human relations skills to interact with others (common courtesy, tact, interest in positive problem solving, empathy, and logical organization of ideas).
- Understand and effectively carry out oral and written directions.
- Give technical advice, training, and work instructions to others in a positive and effective manner.
- Organize and plan work to meet regulations and deadlines.
- Handle physical tasks such as lifting, moving materials, and supplies, stacking and retrieving materials.

### **Revenue Tax Specialist (salary range of \$18.45 - \$26.80 per hour)**

Performs entry level professional tax administration work. General supervision is required.

- Performs routine tax administration work with relative independence to win compliance with Minnesota tax laws through customer service, education, sound policy, audit and feedback, and progressive enforcement (*i.e.*, the five phases of the ensure compliance cycle). Performs routine work subject to practices and procedures covered by precedent and policies; may lead one or more technical or office support staff.
- Communicates with taxpayers and/or taxpayer representatives by phone or letter to provide information and assistance regarding tax laws, MDOR policies, and procedures; conducts informational visits with taxpayers to determine if they are in compliance, inform them of problem areas or areas of non-compliance, and to discuss with them how to correct their performance in the future; makes presentations to the general public or speaks to individuals about tax laws, MDOR policies, and procedures.
- Identifies areas where procedures are needed and assists in the development of written procedures, instructions, and manuals; participates in, or assists with, efforts to produce fact sheets, newsletters, and targeted information for the general public.
- Assists in developing, designing, and conducting new training programs and presentations to educate taxpayers in varied tax administration subject matter.
- Participates in the development and design of new training programs for groups of employees performing technical and professional level compliance work including the preparation of lesson plans, content, needs analysis, conduct of the activity, training evaluations, *etc.*
- Assists and provides input into development of unit business work plans.

- Conducts legal and technical research on less complex issues.
- Reports problems taxpayers have with regards to tax laws, rules, procedures, legal policies, and administrative, quality, or performance issues.
- Independently conducts office tax liability audits involving basic/routine issues by applying appropriate law, policy, and procedures, to determine proper tax liability. Independently conducts on-site tax liability audits involving less complex tax issues.
- Monitors and follows up on self-audits.
- Informs taxpayers of problems or discrepancies found in records and provides information to taxpayers on how to correct records and returns.
- Performs preliminary nexus determination investigations of less complex businesses.
- Recognizes the need for a possible residency determination investigation of individuals and makes referrals; recognizes the need for third party investigations & makes referrals.
- Verifies and processes routine claims for refund.
- Assists with personal contact with non-registered, non-filing persons to obtain registration, filing, and payment of taxes due.
- Assists in “investigation of leads” for detection of non-compliant taxpayers.
- Provides background information for case presentation.
- Makes referral for criminal case determination.
- May assist with civil enforcement actions of less complex nature.
- Creates and maintains audit templates.
- Creates, maintains, and updates databases

Skills, Education, and Experience:

- Bachelor degree in a business concentration such as, Accounting, Business Management, Finance, *etc.*, in order to apply for an RTS level type job
- General knowledge of accounting principles and practices; auditing standards, principles and practices; and audit report processing procedures sufficient to complete examples of work cited above
- General technical tax knowledge including court rulings, regulations, and administrative policies and procedures
- Working knowledge of personal computer operations and software programs and electronic filing/processing systems used by MDOR in its internal and external operations.

Skill in:

- Customer service and interpersonal business conduct sufficient to support the agency’s mission
- Oral and written communications and presentation sufficient to apply to education programs, individual information exchanges, and telephone and/or written communications efforts
- Reading comprehension, problem solving, and analysis sufficient to understand tax laws and policies, identify problems and resolutions, and satisfactorily perform examples of work

Special job demands: Travel

## **Revenue Tax Specialist Intermediate (salary range of \$20.31 - \$29.79 per hour)**

Performs journey professional tax administration work. Performs tax administration work with relative independence to win compliance with Minnesota tax laws through customer service, education, sound policy, audit and feedback and progressive enforcement (*i.e.*, the five phases of the ensure compliance cycle). Performs work subject to advisory guidance covered by precedent and policies; may lead one or more professional, technical or office support staff on specific areas of tax administration work. Limited supervision required.

This class differs from the Revenue Tax Specialist because it applies specialized knowledge of tax law and MDOR policies and it functions with greater independence, seeking guidance only for unique or complex situations. It differs from the Revenue Tax Specialist Senior because that class is responsible for issues of higher complexity, performs work applying a greater degree of specialized knowledge, and directs work of more or higher levels of professional staff.

- Communicates with taxpayers and/or taxpayer representatives by phone, letter, or in-person visits to provide information and assistance regarding complex questions concerning tax laws or MDOR policies and procedures and to inform them of problems or discrepancies found in records and how to correct them; responses may require extensive research.
- Conducts informational visits with taxpayers to determine if they are in compliance, to inform them of problem areas or areas of non-compliance, and to discuss with them how to correct their performance in the future; makes presentations to taxpayer groups or associations about more complex tax laws, MDOR policies, and procedures.
- Identifies areas where procedures are needed, provides input for procedural changes, and assists in the development of written procedures, instructions, and manuals in areas of complex tax law and other similarly difficult or unfamiliar subject matter; leads or participates in efforts to design specialized fact sheets, newsletters, and targeted information for the general public.
- Develops, designs, and conducts new training programs and presentations to educate taxpayers in varied tax administration subject matter.
- Participates in the development and design of new training programs for groups of employees performing technical and professional level ensure compliance work including the preparation of lesson plans, content, needs analysis, conduct of the activity, training evaluations, *etc.*
- Assists and provides input into development of unit business work plans.
- Conducts legal and technical research on more complex or very difficult issues.
- Reports problems taxpayers have with regards to tax law, rules, procedures, legal policy, administrative, quality, or performance issues; researches and recommends solutions.
- Reviews, evaluates, and proposes improvements and other changes to established or proposed procedures, instructions, and manuals and MDOR processing systems.
- Participates as an active member of various tax policy teams.

- Independently conducts office tax liability audits involving multiple issues by applying appropriate law, policy, and procedures, to determine proper tax liability.
- Independently conducts on-site tax liability audits involving relatively complex tax issues; may serve as “auditor-in-charge” of such audits with another junior tax specialist assigned to participate on the audit.
- Develops, monitors, and follows up on self-audits.
- Performs nexus determination investigations of complex businesses and assists in investigation of more complex businesses.
- Responds to less complex single issue appeals of individual tax change notices.
- Performs less complex residency determinations and has limited knowledge of allocation rules for income of individuals; assists in more complex residency investigations.
- Performs minor third party investigations by use of routine third party investigations, obtaining bank and credit statements.
- Verifies and processes routine claims for refund.
- Lead non-filer projects; makes personal contact with non-registered, non-filing persons to obtain registration, filing, and payment of taxes due.
- Develops, designs, and conducts new training programs and presentations to educate taxpayers in varied tax administration subject matter.
- Investigates leads for detection of non-compliant taxpayers.
- Assists AG staff with case presentation and participates in hearing procedures.
- Performs initial analysis and research to determine criminal case potential.
- May assist with civil enforcement actions such as seizures and inspections.
- Creates and maintains audit templates.
- Creates, maintains and updates databases.

Knowledge of:

- General knowledge of accounting principles and practices; auditing standards, principles and practices; and audit report processing procedures sufficient to complete examples of work cited above.
- General technical tax knowledge including court rulings, regulations, and administrative policies and procedures.
- Working knowledge of personal computer operations and software programs and electronic filing/processing systems used by MDOR in its internal and external operations.



Skill in:

- Customer service and interpersonal business conduct sufficient to support the agency's mission.
- Oral and written communications and presentation sufficient to apply to education programs, individual information exchanges, and telephone and/or written communications efforts.

Ability to:

- Comprehend written documents, resolve problems, and analyze work products.
- Plan, direct, and review the work of others.

Education:

- Bachelor degree in a business concentration such as, Accounting, Business Management, Finance, *etc.*

Special job demands: Travel

**Revenue Tax Specialist Senior (salary range of \$23.30 - \$34.34 per hour)**

Performs advanced professional tax administration work. Performs highly difficult and specialized tax administration work to win compliance with Minnesota tax laws through customer service, education, sound policy, audit and feedback, and progressive enforcement (*i.e.*, the five phases of the ensure compliance cycle). Performs work independently, subject to advisory guidance; provides direction, guidance, technical assistance, and training to all levels of Revenue Tax Specialists and/or clerical or technical or professional employees on a variety of tax administration work. Limited supervision required.

This class differs from the Revenue Tax Specialist Intermediate because it is responsible for issues of higher complexity, applies a greater degree of specialized knowledge to work, and directs work of more or higher levels of professional staff. It differs from the Revenue Tax Specialist Principal because that class is responsible for the most complex, visible, and difficult issues, represents the highest level of technical expertise, and has a stronger role in policy.

- Communicates with taxpayers and/or taxpayer representatives by phone, letter, or in-person visits to provide information and assistance regarding complex questions concerning tax laws, MDOR policies, and procedures which require extensive research; conducts informational visits with taxpayers to determine if they are in compliance, informs them of problem areas or areas of non-compliance, and to discuss with them how to correct their performance in the future.
- Leads or participates in efforts to produce varied education efforts including designing highly technical fact sheets, newsletters, and targeted information; speaks to the media and/or groups of practitioners, attorneys, and other tax professionals about more complex tax issues; assists in development of formal communication for media distribution.

- Identifies areas where procedures are needed, develops written procedures, instructions and manuals in areas of complex tax law and other similarly difficult or unfamiliar subject matter.
- Develops, designs, and conducts new training programs and presentations to educate taxpayers in varied tax administration subject matter.
- Participates in the development and design of new training programs for groups of employees performing technical and professional level ensure compliance work including the preparation of lesson plans, content, needs analysis, conduct of the activity, training evaluations, *etc.*
- Assists and provides input into development of unit, division, and/or MDOR business work plans; identifies goals and objectives for work unit.
- Assists in conducting extensive legal and technical research that may be precedent setting and or involving highly complex issues.
- Reports problems taxpayers have with regards to tax law, rules, procedures, legal policy, administrative, quality, or performance issues; researches and identifies solutions; provides formal input and assists with drafting of statutory language.
- Reviews, evaluates, and proposes improvements and other changes to established or proposed procedures, instructions, and manuals and MDOR processing systems.
- Participates as an active member of various tax policy teams.
- Conducts office tax liability audits involving difficult multiple issues by applying appropriate law, policy, and procedures to determine proper tax liability; plans, develops, and monitors compliance projects.
- Conducts complex on-site tax liability audits involving difficult multiple issues; may serve as “auditor-in-charge” of such audits with another junior tax specialist assigned to participate on the audit.
- Develops and designs self-audit programs and processes for specific or relatively new or unique tax situations and conditions.
- Informs taxpayer of problems or discrepancies found in records and provides information to taxpayer on how to correct records and returns.
- Conducts nexus investigations of more complex businesses.
- Plans and completes the most difficult cases such as sensitive audit assignments involving taxpayers with high visibility tax protesters, belligerent taxpayers, and those which may attract the news media.
- Resolves complex controversial politically-sensitive precedent setting appeals submitted by taxpayers and their representatives.
- Conducts residency investigations; performs allocation of income of more complex individuals under applicable rules; assists in embezzlement and or fraud investigations.
- Conducts third party investigations of more complex nature of individuals, including use of subpoenas and exchange of IRS and inter- MDOR information exchanges.
- Verifies and processes claims for refund involving taxpayers with high visibility and those who may attract the news media.
- Leads non-filer projects; makes personal contact with non-registered, non-filing persons to obtain registration, filing, and payment of taxes due.

- Identifies groups of non-compliant taxpayers and samples groups to determine level of non-compliance.
- Assists Attorney General staff with case presentation, participates in hearing procedures, and appears at appeals hearings to discuss technical issues involved in an audit.
- Performs analysis and research to determine criminal case potential.
- Performs civil enforcement actions such as seizures and inspections.
- Creates and maintains audit templates.
- Creates, maintains, and updates databases.

Knowledge of:

- Extensive knowledge of accounting principles and practices, auditing standards, principles and practices, and audit report processing procedures sufficient to complete examples of work cited above.
- Extensive technical tax knowledge including court rulings, regulations, and administrative policies and procedures.
- Extensive knowledge of Minnesota tax laws for general and specific application, of court decisions, and of attorney general opinions and policies.
- Working knowledge of personal computer operations and software programs and electronic filing/processing systems used by the MDOR in its internal and external operations.
- Extensive knowledge of electronic processing accounting systems.
- Information exchange and disclosure policy and agreements.

Skill in:

- Customer service and interpersonal business conduct sufficient to support the agency's mission.
- Oral and written communications and presentation sufficient to apply to education programs, individual information exchanges, and telephone and/or written communications efforts.

Ability to:

- Comprehend written documents, resolve problems, and analyze work products.
- Plan, direct, and review the work of others.

Education:

- Bachelor degree in a business concentration such as Accounting, Business Management, and Finance.

Special job demands: Travel

## **Revenue Tax Specialist Principal (salary range of \$24.94 - \$37.00 per hour)**

Performs senior advanced professional tax administration work. Performs highly advanced and specialized tax administration work to win compliance with Minnesota tax laws through customer service, education, sound policy, audit, and feedback and progressive enforcement (*i.e.*, the five phases of the ensure compliance cycle). Works independently and plans and organizes all phases of work within broad program guidelines; provides direction, guidance, technical assistance and training to all levels of Revenue Tax Specialists and/or clerical or technical or professional employees on a variety of tax administration work. Positions at this level differ from other Revenue Tax Specialists because they are highly technical and typically the expert in a particular area. Limited supervision required.

- Communicates with taxpayers and/or taxpayer representatives by phone, letter, or in-person visits, to respond to questions or concerns of a highly technical nature regarding tax law and MDOR policies and procedures, requiring extensive research or interpretation; conducts informational visits with taxpayers to determine if they are in compliance, informs them of problem areas or areas of non-compliance and to discuss with them how to correct their performance in the future.
- Leads or participates in the leadership of varied education efforts including designing highly technical fact sheets, newsletters, and targeted information; speaks to the media and/or groups of practitioners, attorneys, and other tax professionals about the most complex tax issues; participates in development of formal communication for media distribution, for wide-spread dissemination among taxpayers, tax return preparers, tax law practitioners, and others who serve as a primary information source regarding a particular procedure, process or policy.
- Identifies areas where procedures are needed; designs and develops processes and procedures, instructions, and manuals for new tax types and new and innovative taxation schemes; develops written procedures, instructions, and manuals in areas of complex tax law and other similarly difficult or unfamiliar subject matter.
- Develops, designs, and conducts new training programs and presentations to educate taxpayers in varied tax administration subject matter.
- Participates in the development and design of new training programs for groups of employees performing technical and professional level compliance work including the preparation of lesson plans, content, needs analysis, conduct of the activity, training evaluations, *etc.*
- Assists and provides input into development of unit, division, and/or MDOR business work plans; identifies goals and objectives for work unit.
- Conducts extensive legal and technical research that may be precedent setting and or involving highly complex issues.
- Identifies problems taxpayers have with law, rules, procedures, legal policy, administrative, quality or performance issues; researches and evaluates laws, policies and solutions to problems; assists with drafting of statutory language; provides testimony.

- Assists in the development of new tax administration policy and develops procedures related to new or changed policy.
- Reviews, evaluates, designs, and administers improvements and other changes to established or proposed procedures, instructions and manuals, and MDOR processing systems.
- Participates as an active member of various tax policy teams.
- Designs and develops new and improved office audit programs, processes, and procedures.
- Plans develops and monitors compliance projects involving difficult multiple tax issues.
- Conducts complex on-site tax liability audits involving difficult multiple issues and/or conducts highly complex team audits, typically at the multi-national level; serves as “auditor-in-charge” with from 1 to 3 junior tax specialists assigned to participate on the audit.
- Designs and develops self-audit programs and processes for specific or relatively new or unique tax situations and conditions.
- Informs taxpayer of problems or discrepancies found in records provides information to taxpayer on how to correct records and returns.
- Conducts unitary business/most complex sales tax investigations and makes determinations.
- Plans and completes the most difficult cases such as sensitive audit assignments involving taxpayers with high visibility, tax protesters, belligerent taxpayers, and those which may attract the news media.
- Resolves highly complex, controversial, politically-sensitive, precedent-setting appeals submitted by taxpayers and their representatives.
- Conducts most complex residency investigations and applies the rules of income allocation; assists or performs embezzlement and/or fraud investigations.
- Conducts third party investigations of the most complex nature of individuals involving extensive use of subpoenas and indirect methods of investigation including bank deposits, source and application of funds, T-accounts, network and mark-up auditing techniques.
- Identifies groups of non-compliant taxpayers and samples groups to determine level of non-compliance.
- Assists Attorney General staff with case presentation, participates in hearing procedures, and appears at appeals hearings to discuss technical issues involved in an audit.
- Performs analysis and research to determine criminal case potential.
- Performs civil enforcement actions such as seizures and inspections.
- Oversees the development of templates.
- Creates, maintains, and updates databases.

Knowledge of:

- Extensive knowledge of accounting principles and practices; auditing standards, auditing principles and practices; and audit report processing procedures sufficient to complete examples of work cited above.

- Extensive technical tax knowledge including court rulings, regulations, and administrative policies and procedures.
- Extensive knowledge of Minnesota tax laws for general and specific application, of court decisions, attorney general opinions, and policies.
- Working knowledge of personal computer operations and software programs and electronic filing/processing systems used by the MDOR in its internal and external operations
- Extensive knowledge of electronic processing accounting systems.
- Thorough knowledge of information exchange and disclosure policy and agreements.

Skill in:

- Extensive customer service skills and interpersonal business conduct sufficient to support the agency's mission.
- Extensive oral and written communications and presentation skills sufficient to direct the work of others, to present testimony, and to draft policy documents.

Ability to:

- Comprehend written documents, resolve problems, and analyze work products.
- Plan, direct, and review the work of others.

Education:

- Bachelor degree in a business concentration such as accounting, business management, or finance.

Special job demands: Travel

**Revenue Collection Officer 2 (salary range of \$17.24 - \$24.94 per hour)**

- Collects delinquent state taxes by investigating and taking legal action to ensure that all taxpayers fulfill their state tax obligation; performs related work as required.
- Applies professional knowledge of tax laws and collections policies and procedures, acquired through an accumulation of job experience and a series of job-related training courses, to investigate and secure the payment of delinquent taxes by telephone and direct taxpayer contact.
- Review taxpayer files to gather pertinent facts and information, and establish the need for additional information by comparing the tax return to additional file information, statutory requirements, and MDOR policies and procedures. Verify file material to validate the appropriateness of the assessment by comparing to other MDOR documents and records and to MDOR policies and procedures.
- Request voluntary payment of taxpayer's delinquent taxes to eliminate tax liability by calling, writing, or in-person contact with the taxpayer.
- Identify taxpayer's asset and income sources to initiate the most effective collection actions by verifying employment, bank accounts, and other pertinent information with taxpayer's employer, banker, landlord, etc. Conduct routine on-site investigations to

discover assets not apparent from file information by observing individual and business activities through personal visits and examination of third-party records.

- Determine routine collection actions (*i.e.*, liens, levies, payment plans) to collect delinquent taxes by applying the appropriate MDOR policies and procedures to specific collection situations.

Knowledge of:

- Pertinent laws, policies and procedures sufficient to explain tax filing requirements, tax liability, penalty and interest assessments; to ensure due process; to obtain information (*e.g.*, employment, banking, property ownership) necessary for liens and levies; to recognize computer and processing errors.
- MDOR operations sufficient to refer difficult or unusual tax liability questions to appropriate departmental staff. MDOR collection actions sufficient to routinely demand voluntary payment by telephone or in-person, to file liens on property, to levy on wages and bank accounts, to negotiate payment plans.
- Taxpayer files sufficient to identify and correct errors and to research and locate possible assets subject to collection action.
- Investigative techniques (*e.g.*, observations, personal interviews, and examination of third party records) sufficient to conduct routine on-site investigations to discover assets not apparent from file information.

Skill in:

- Reading comprehension sufficient to review and interpret written documents (*e.g.*, tax laws, correspondence, and forms).

Ability to:

- Communicate verbally by telephone and in-person; in writing by letter and instructions sufficient to gather information (*e.g.*, tax records, dates, and employment) and provide information to taxpayers, their representatives and departmental employees.

### **Revenue Collection Officer 5 (salary range of \$22.42 - \$33.18 per hour)**

Performs professional specialized and/or lead tax collection work. The Revenue Collections Officer 5 applies specialized professional knowledge of tax law, collections principles, policies and procedures acquired through an accumulation of job experience and a series of continually more advanced job-related training courses to direct the investigation and collection of delinquent taxes of the most difficult cases, to train collections staff, to analyze and research collection laws in order to develop and conduct specialized statewide programs guided by general policies and occupational principles. General supervision required.

- Conduct on-site investigations of difficult collection cases to discover assets not apparent from file information by observing individual and business activities through personal visits and examination of third-party records.

- Review, recommend, or perform specialized and/or complex collection actions (e.g. compromises, cash drawer levies, seizures, partial lien releases) to collect taxes owed the department by applying MDOR policies and regulations to the taxpayer's situation.
- Resolve collection cases that are sensitive, highly visible, high dollar, multi-district and/or potentially dangerous to collect taxes owed the department to diminish negative or adverse impact on MDOR by utilizing specialized collection techniques.
- Train and inform MDOR employees about state collections laws and department policies and procedures by providing on-the-job training, classroom instruction, formal presentation, and preparation of written materials.
- Provide lead work direction to co-workers to ensure work is completed in the most efficient manner by distributing and reviewing work assignments, providing work direction, answering questions, and providing input for performance reviews.
- Write procedures manuals to ensure consistent and uniform application of MDOR policies and procedures, preparing written copy, editing written materials, and distributing manuals and subsequent revisions.
- Answer questions from and provide advice to management and co-workers on a variety of issues and questions concerning the development, evaluation, or application of collection laws, policies or procedures.
- Develop and conduct specialized, statewide collection programs to enable MDOR to utilize its legislative collection authority by researching and implementing legal procedures regarding the acquisition of real and personal property or the collection of taxes from taxpayers filing for bankruptcy.

Knowledge of:

- Pertinent laws, policies, and procedures sufficient to explain tax filing requirements, tax liability, penalty and interest assessments; to ensure due process; to establish tax liabilities from departmental and third party sources; to write and edit procedures; to recommend/initiate new or modified statewide collections programs.
- MDOR collection actions sufficient to demand voluntary payment by telephone, in-person and conferences; to recommend and/or initiate bank, wage and cash drawer levies, liens, subpoenas, judgments, commissioner-filed returns, license revocations and seizure of real and personal property.
- Investigative techniques (e.g., observations, personal and third party interviews, the examination of third party records) sufficient to discover and determine assets, additional sources of income and the ability to pay liabilities, penalties and interest; to advise other professional collections staff in these techniques.

Skill in:

- Reading comprehension sufficient to review and interpret written documents (e.g., tax laws, correspondence and forms).



Ability to:

- Communicate verbally by telephone and in-person sufficient to direct and train professional employees in laws, policies, and procedures; to negotiate settlements with taxpayers and their representatives.
- Communicate in writing sufficiently to write and edit Revenue procedures, forms and correspondence for departmental staff, taxpayers, their representatives, and others.

Special job demands: Travel

### **Revenue Special Investigator 1 (salary range of \$22.48 - \$33.18 per hour)**

Performs professional investigative work. Uses a microcomputer to format data on cases/witnesses, identify patterns, list evidence and other materials, profile suspects, record evasion schemes, and record devices of concealment. General supervision required.

- Investigates alleged cases of tax fraud in order to identify criminal violations of Minnesota Tax Law for criminal prosecution; performs related work as required.
- Interviews witnesses and subjects of criminal investigations to gather evidence of tax fraud using interview techniques, human interaction, knowledge of business and personal transactions, knowledge of constitutional rights and verbal communication skills.
- Prepares subpoenas/search warrants to produce evidence of tax crimes using organizational materials and cameras.
- Testifies in court, appearing as a witness for MDOR in criminal prosecutions so that facts discovered in investigations are presented using tax returns, investigative notes, and knowledge of MDOR systems.
- Prepare reports to document evidence of criminal activity so that businesses and individuals are properly charged and prosecution may begin using witness statements, audit work papers, interview statements, tax return information, bank statements, and criminal history.
- Reads/compares computer printouts and tax returns to determine compliance with filing requirements, locate individuals, determine correctness of returns and violations of criminal statutes by applying knowledge of tax law, accounting methods, and procedures and knowledge of MDOR systems and procedures.

Knowledge of:

- Accounting principles and techniques and ability to apply them in analyzing taxpayer's books and records to find evidence of tax evasion. The tax laws of the State of Minnesota sufficient to determine statutory requirements of the Income Tax Act, Sales and Use Tax Act and other laws administered by the commissioner of Revenue. Departmental systems and procedures sufficient to understand audit selection, processing tax returns, tax payments, and the recording of each. Rules of Evidence and Rules of Court to ensure admissibility of evidence and that proper court procedure are followed.

- Use human relations skills to interact with others within and outside the Department of Revenue.
- Exercise sound judgment and logic to arrive at conclusions based on information gathered.
- Communicate orally in order to testify in court proceedings and communicate effectively with attorneys and public officials.
- Write clear and concise reports to document evidence and violations of criminal statutes.
- Establish and maintain effective working relationships in order to maintain public trust and yet obtain the information/evidence needed.
- Apply basic techniques, principles, and methods of criminal investigation and use technical investigative equipment to gather evidence needed to establish proof of criminal violations of tax law.
- Utilize computerized system to access tax data on individuals and businesses.

Education:

- Either an associate degree with a law enforcement background or a bachelor degree without the law enforcement experience.

Special job demands: Travel

**Revenue Special Investigator 2 (salary range of \$24.08 - \$35.71 per hour)**

Performs professional investigative work. Uses a microcomputer to format data on cases/witnesses, identify patterns, list evidence and other materials, profile suspects, record evasion schemes, and record devices of concealment. General supervision required.

- Investigates alleged cases of tax fraud in order to identify criminal violations of Minnesota Tax Law for criminal prosecution; performs related work as required.
- Interviews witnesses and subjects of criminal investigations to gather evidence of tax fraud using interview techniques, human interaction, knowledge of business and personal transactions, knowledge of constitutional rights and verbal communication skills.
- Prepares subpoenas/search warrants to produce evidence of tax crimes using organizational materials and cameras.
- Testifies in court, appearing as a witness for MDOR in criminal prosecutions so that facts discovered in investigations are presented using tax returns, investigative notes and knowledge of department systems.
- Prepare reports to document evidence of criminal activity so that businesses and individuals are properly charged and prosecution may begin using witness statements, audit work papers, interview statements, tax return information, bank statements and criminal history.
- Reads/compares computer printouts and tax returns to determine compliance with filing requirements, locate individuals, and determines correctness of returns and violations of criminal statutes by applying knowledge of tax law, accounting methods, and procedures

and knowledge of department systems and procedures. Interviews witnesses and subjects of criminal investigations to gather evidence of tax fraud using interview techniques, human interaction, knowledge of business and personal transactions, knowledge of constitutional rights and verbal communication skills.

Knowledge of:

- Accounting principles and techniques and ability to apply them in analyzing taxpayer's books and records to find evidence of tax evasion
- The tax laws of the State of Minnesota sufficient to determine statutory requirements of the Income Tax Act, Sales and Use Tax Act and other laws administered by the Commissioner of Revenue
- Departmental systems and procedures sufficient to understand audit selection, processing tax returns, tax payments and the recording of each
- Rules of Evidence and Rules of Court to ensure admissibility of evidence and that proper court procedures are followed
- Human relations skills to interact with others within and outside the Department of Revenue

Ability to:

- Exercise sound judgment and logic to arrive at conclusions based on information gathered.
- Communicate orally in order to testify in court proceedings and communicate effectively with attorneys and public officials.
- Write clear and concise reports to document evidence and violations of criminal statutes.
- Establish and maintain effective working relationships in order to maintain public trust and yet obtain the information/evidence needed.
- Apply basic techniques, principles, and methods of criminal investigation and use technical investigative equipment to gather evidence needed to establish proof of criminal violations of tax law.
- Utilize computerized systems to access tax data on individuals and businesses.

Education:

- Either an associate degree with a law enforcement background or a bachelor degree without the law enforcement experience.

Special job demands: Travel

### **Management Analyst 3 (salary range \$20.39 – \$29.90 per hour)**

Performs professional organization and administrative analysis work.

Procedural control, conduct studies of departmental organization, methods and systems to recommend and install new work methods and procedures by determining and monitoring the overall study process and making final recommendations for state-wide or department-wide programs in areas such as records and publications management; policy and procedures development/analyses; organization of office space; work and information flow; systems analysis/design; data processing; fiscal and budgetary analysis; cost/benefit analysis; review of legislation; and analysis of organizational structure may direct the work of other personnel temporarily assigned from other operating divisions who are assisting in the studies; performs related work as required.

- Evaluates policy, rules, operations, work procedures, and/or work methods in the department to provide assistance in solving managerial and procedural problems by defining needs and determining the methodology to be used to monitor, audit, and review operations in assigned department-wide/state-wide projects or operational areas; by developing objectives and determining the resources required; by directing the work of individuals from other operating divisions/agencies who may be temporarily assigned to assist with projects; and by developing work plans and assigning priorities and time limits.
- Writes or coordinates the writing of reports to provide documentation of findings and to present recommendations by serving as the consultant/coordinator for others assisting in the study; by reviewing the information for accuracy; and by identifying alternatives and options in preparing final recommendations.
- Plans and develops data processing systems to facilitate quick access to and manipulation of data by determining data base requirements, working with programming and systems personnel; by providing advice and technical guidance to others in regard to feasible alternatives and systems; by formulating for review a program of data base development; and by designing and implementing systems and sub-systems and analyzing data bases for validity and reliability.
- Plans and implements altered work procedures, simplified and improved techniques to assist the department in meeting operating needs with greater efficiency by following through on the reassignment of functions, lines of authority, staffing needs, etc.; by applying forms analysis and design, distribution of work, methods analyses and work measurement techniques; by applying revised systems procedures to the operation of existing procedures; and by preparing manuals and other informational materials and making oral presentations to affected staff.

Knowledge of:

- Organization, controls, and techniques used in dealing with procedural and management problems sufficient to determine the methodology and resources required and to develop work plans to complete assigned studies

- Organizational structure, methods and procedures of operating divisions sufficient to review, analyze and evaluate operations and recommend and install new/revised procedures
- Modern office equipment and electronic data processing principles sufficient to design and implement systems for their use
- Techniques of job analysis sufficient to measure and simplify work procedures and analyze work methods
- Accounting techniques sufficient to perform fiscal and budgetary management

Ability to:

- Appraise and evaluate problems of a procedural nature.
- Prepare complete comprehensive reports.
- Establish and maintain effective working relationships with supervisors and employees during the course of study and installation of new procedures.

#### **Management Analyst 4 (salary range of \$24.17 - \$35.85 per hour)**

Performs advanced professional organization and administrative analysis work.

This position is recognized as a departmental expert, directs and/or conducts and executes studies for areas with little or no procedural precedent which have major department and/or state-wide policy implications and which may involve major departmental reorganizations, liaison with staff from other agencies, as well as performing as a lead worker for interdisciplinary task forces, to provide management with information necessary for decision-making and long-range organizational or systems planning in an area such as records and publications management; policy and procedures development/analyses; organization of office space; work and information flow; systems analysis/design; data processing; fiscal and budgetary analysis; cost/benefit analysis; review of legislation; and analysis of organizational structure; performs audit and quality assurance functions in terms of providing lead work direction and review to high-level professional staff; performs related work as required.

- Develops long-range administrative and management strategies to resolve organizational issues by clarifying the scope of issues and assigning responsibility and tasks to various personnel; by developing documents which represent desired directions and ensuring compatibility of new policies with existing statutes, etc.; and by ensuring proper review and feedback from those concerned.
- Directs the implementation of new, improved work procedures, simplified and improved techniques to assist the department in meeting operating needs with greater efficiency by applying forms analysis and design, distribution of work, methods analyses and work measurement techniques, revise system procedures and by preparing manuals and other informational materials and making oral presentations to affected staff.
- Consults/advises the departmental decision makers, the legislature or others on events or program conditions to communicate significant developments and issues by performing a complete analysis and inventory report; by recommending changes in

reporting techniques and maintaining a reports control program; and by using pertinent newsletters, journals and commercial services, newspapers, internal memoranda and professional contacts within and outside of government.

Knowledge of:

- Organization, controls, and techniques used in dealing with procedural and management problems
- Organizational structure and methods and procedures of operating divisions, with particular reference to the department to which assigned, principles and techniques involved in work simplification and work measurement studies
- Modern office equipment such as data processing, duplicating, and accounting devices and their use

Ability to:

- Appraise and evaluate problems of a procedural nature.
- Conduct detailed analyses of work flow and prepare and interpret flow charts. Prepare complete, comprehensive reports.
- Establish and maintain effective working relationships with division heads during studies and during their installation.

### **Project Consultant Senior (salary range of \$24.09 - \$35.55 per hour)**

Performs advanced professional technical expert work. An employee in this class provides guidance, advanced specialized technical expertise for a team doing evaluation, development, design, testing, and/or implementation in a project environment. Activities may be focused on singular or limited number of activities/programs (implementation, design, testing, *etc.*) and/or functional areas.

- Serves as the expert technical resource for other project and agency staff involved in the design and testing of project activities so that progress is maintained by using modeling, Gantt Charts, PERT Diagrams, and other techniques.
- Evaluates effectiveness of current practices and recommends re-engineering when appropriate to ensure desired outcomes by using focus groups, brainstorming, and other data collection and analytical methodologies.
- Analyzes problems regarding activities, identifies source of problems and solves the problem to ensure desired outcomes by initiating modifications or redirecting the problem to another team for resolution.
- Consults with and advises implementation staff during conversion/implementation to ensure that targets are being met and outcomes achieved through meetings and reports.
- Designs, directs, and conducts comprehensive and intensive "primers" on complex topics to provide project management with information for long-range organizational and systems restructuring and planning by conducting primary and secondary research on program financing, financial controls, program goals, and administrative interrelationships; establishing and facilitating ad hoc study and/or implementation teams

to assist with design and data collection; ensuring broad-based participation and implement recommendations; analyzing procedural, financial, and structural barriers to fiscally efficient and program effective delivery, including an analysis of the flow of service delivery and the interrelationship of system components; appraising and evaluating the desirability and feasibility of fiscal and program restructuring; and developing or directing the development of recommendations to the senior management team.

- Serves as principal analyst, consultant, and project liaison to design, direct and conduct comprehensive cross-agency studies of service delivery systems, and the interrelationships among system components by analyzing the flow of service delivery; and consulting with interdisciplinary team of task force members, consultants, and other staff in developing functional systems.
- Designs and develops concise "white papers" to inform the project management team on specific restructuring and other management decisions by conducting research to provide a comprehensive treatment to complex narrowly defined topics; establishing and facilitating ad hoc study and/or implementation teams to assist with study design and data collection and to ensure broad-based participation in the study; and developing options and recommendations to the senior management team.
- Conducts a review and analysis of the financing of the program by developing prototype format for major sections of the guidebook; conducting cross-cutting financial studies on federal, state, and local components of agency's funding structures and programs; conducting an issues identification process encompassing everyone; and analyzing important topics of state-local fiscal relations.
- Develops detailed written installation work plans by identifying staffing types and quantities needed; types and quantities of consultants needed; need for project facilities and develops a plan to locate, select, and negotiate for appropriate facilities; and identifies equipment and supply needs.

Knowledge of:

- Technical knowledge of the project's subject matter sufficient to operationalize complex project activities; provide advice and guidance to project staff, suggest solutions and alternatives to problems unresolved by professional project staff, and evaluate the quality of project outcomes.
- Project management principles sufficient to synthesize human and fiscal resources, conduct cost/benefits analysis, select from among a variety of methods and techniques to plan and measure project activities, timeframes, and outcomes.

Skill in:

- Statistics and/or research methods, their applications and limitations sufficient to select and use procedures appropriate to problems and to interpret results.
- Functional analysis and problem solving sufficient to distinguish between a problem's symptoms and causes, clearly define the problem or issue, develop solutions and alternatives, and design systems changes resolve the problem/issue.
- Human relations sufficient to coordinate consensus building and guide the expectations of customers, stakeholders, and project staff, lead discussion groups, using a variety of communication styles, and understand the interrelationships of ongoing programs to project activities.
- Written and oral communications sufficient to translate technical and project information to a diverse audience of both non-technical and technical customers and stakeholders, listen to their replies and concerns, and edit written project documents authored by project staff.

Ability to:

- Prioritize among multiple demands for human and fiscal resources sufficient to administer and align these resources to accomplish the project's goals and objectives.
- Comprehend the complex interrelationships between ongoing programs and project activities; between knowledge, information, and data.
- Analyze data, identify problems, and suggest solutions.
- Determine strategy and methodology for carrying out the study and development of proposals.

Special job demands (working conditions, travel, hazards, *etc.*): Employees in this class are appointed to the unclassified service under the authority of M.S. 43A.08 (Subd. 2a) "Temporary unclassified positions. The commissioner, upon request of an appointing authority, may authorize the temporary designation of a position in the unclassified service. The commissioner may make this authorization only for professional, managerial, or supervisory positions which are fully anticipated to be of a limited duration."

Furthermore, this class is only intended to staff projects of limited duration. Projects have defined starting and ending dates, clearly specified objectives which define the scope of the work to be performed and frequently have a temporary organization that is dismantled once the project is completed.



# Appendix E

## Brief Non-Compliance Literature Review

In a study conducted by Weiss for Florida's Revenue Estimating Conference, the author suggests that between 42 to 44 percent of the increased elasticity can be accounted for by increased evasion.<sup>109</sup> For an overall elasticity of -0.94, this suggests that the elasticity associated with evasion is -0.42, translating into a 13.7 percent reduction in consumption due to evasion. This is 30.6 million packs of cigarettes.

### Cigarette Tax Non-Compliance

A recent cigarette tax gap study in Minnesota found that information obtained on cigarette consumption of Minnesotans who acknowledge purchasing cigarettes outside the state suggested a tax gap for 2007 approaching \$20 million, almost 5 percent of cigarette tax revenue.<sup>110</sup> The author suggests this is likely to be biased downward, due to the general phenomenon where individuals tend to underreport cigarette tax consumption. A second approach, using USDA data to estimate consumption and taxable sales, was developed by the author. This methodology suggests a range for the tax gap of between 2 percent and 8 percent of taxable revenue. This range brackets the \$20 million amount developed in the first approach.

Blumenthal finds evidence indicating that the geographic distribution of the tax gap is related to differences in state cigarette tax rates. Minnesotans who reside in counties bordering North and South Dakota, where the 2007 tax was lower than in Minnesota, were more likely to report out-of-state purchases. In sum, using data from the MDOR retail survey, taxed sales in counties bordering North and South Dakota were depressed relative to the state's interior, while consumption was not.

Merriman used a creative approach to estimate tax avoidance in Chicago and Cook County.<sup>111</sup> By examining a random sample of discarded cigarette packs, Merriman examined whether Chicago taxes have been paid on the cigarettes consumed in Chicago. Price disparities in the Chicago metro area are huge. At the time the author was conducting his research, portions of the City of Chicago, which has a combined state and local tax of \$3.66 per pack, border on Indiana, which until July of 2007 had a state tax of only \$0.55 cents per pack and has no local cigarette excise taxes. These large tax differentials between Chicago and neighboring jurisdictions provide an incentive for smokers to buy cigarettes outside Chicago. His findings were startling – three-quarters of the packs found on the streets of Chicago did not display a Chicago tax stamp. The author attributes this finding to an increase in the cost of tax avoidance. The implications of this research are that evasion is much higher the closer one is to a border where there is a significant tax differential.

Fitz develops methodologies to estimate cigarette and tobacco products tax evasion in California for their Board of Equalization.<sup>112</sup> The author developed an econometric model and used the results to estimate total California cigarette consumption and evasion. Fitz finds a 5 percent casual consumer evasion rate.<sup>113</sup> This finding is consistent with the 2008 Minnesota tax gap study. Fitz takes his research one step further, by estimating cigarette tax evasion by retailers. This estimated evasion is more than double (10.2 percent) that of casual consumers.

Applying this methodology to Minnesota yields an overall estimate of 39 million packs of cigarettes being consumed but evading Minnesota's cigarette tax. This figure can be disaggregated as follows: 12.8 million packs by casual consumers and 26.3 million packs by retailers.

Applying several of the methodologies discussed above to Minnesota suggests that Minnesota could expect evasion on between 30.6 and 39.1 packs of cigarettes annually, with 95 percent of the evasion happening at the retail level.

### **Tobacco Products Non-Compliance**

Tobacco Product elasticities and evasion are much less researched. In fact, until recently few states actually broke out the various components within this category. Interviews with various state tax department representatives indicate this was because tobacco products comprise a small part of total cigarette and tobacco revenue.

In estimating excise tax evasion for tobacco products, Fitz (2007) relied heavily on U.S. Census data for individual retail industries. He adjusted the Census data to reflect the likelihood of lower per capita California tobacco products consumption by assuming California's share of U.S. cigarette consumption. The basic procedure was to estimate California tobacco products sales using taxable sales data and U.S. Census data (adjusted to reflect California) and compare these estimates to sales implied by excise tax records. The difference in the two figures provides an estimate of evasion.

The author estimated tobacco products sales for retail industries for which JD Michael had U.S. Census data by adjusting each retail industry for California except for cigar shops and cigarette shops. The U.S. Census Bureau has data for cigarette sales and tobacco products sales. Using this information, Fitz determined that about 8 percent of cigarette and tobacco products sales are tobacco products. The U.S. Census Bureau "product lines" reports for retail sales indicate that in 2002 retail sales of cigarettes and tobacco products ranged from about 1 percent of all sales for food stores to 8.9 percent of all sales for gas stations. Industry survey data indicates that about 58 percent of sales by cigar shops are tobacco products. He applied these percentages to Board of Equalization 2005 taxable sales by industry and adjusted food and drug store calculations to reflect the relatively large proportions of sales of these industries that are exempt from taxable sales. After calculating estimates of retail tobacco products sales, the author adjusted them to estimate wholesale sales by applying margin percentage factors available for specific retail industries in a report published by the U.S. Bureau of Economic Analysis. Alarming, this approach yielded an estimate of more than 60 percent non-

compliance (61.9 percent) at the wholesale level. Fitz assumed a 5 percent non-compliance rate for casual consumers.

While these results cannot be directly applied to Minnesota, what JD Michael can infer is that, even at a tax of 45.1 percent of the wholesale price, it appears that significant evasion can occur in tobacco products taxation. As discussed above, Minnesota's new tax structure for tobacco products is much higher than in California. What makes Fitz's work relevant is the potential magnitude of evasion. As JD Michael indicated earlier and will continue to emphasize throughout this report, any analysis of tobacco products is more difficult than for cigarettes because several kinds of products are involved and little data is available especially when compared to cigarettes. In addition, much of the product in this category is not stamped. Recommendations for reducing this potential evasion are developed in Section 8 of the report.

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# Appendix F

## Synopsis of Enforcement Issues Identified in Literature

Research suggests that in the U.S. alone smuggling costs about \$5 billion per year in lost state tax revenues.<sup>114</sup> Worldwide it is estimated that more than 10 percent of cigarettes bought around the world are sold illegally.<sup>115</sup> Drawing on a legal synopsis on illicit tobacco trade within and across the borders of the U.S., information in this appendix outlines major causes of illicit tobacco trade and potential strategies to combat this growing trend.<sup>116</sup>

### Definitions used in this synopsis

- Bootlegging:** When individuals or small groups purchase a threshold amount of tobacco products in a low tax state for illegal resale in a high tax state (e.g., a product being purchased in Virginia and resold illegally in New York).
- Illicit Trade:** A broader term that encompasses “any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale, or purchase”.<sup>117</sup>
- Smuggling:** The illegal trade across borders.<sup>118</sup>
- Tax Avoidance:** Taking advantage of legal loopholes or exemptions from tax.
- Tax Evasion:** Illegally avoiding paying a required tax.

### Illicit Trade: Sources of Problem

Illicit trade occurs primarily because a disparity exists in cigarette and tobacco products across municipalities, states, and countries. In addition, Alderman suggests that penalties for smuggling tobacco are lenient and therefore are insufficient to act as a disincentive. The author suggests that in many cases contraband cigarettes are simply confiscated, resulting in a loss of profit, but no real legal deterrent. Jail time is typically only a few years unless the crime involves guns or drugs. It should be noted from the outset that while many tobacco control issues can be addressed at the state or local level, most laws dealing with smuggling are federal in nature and are enforced by federal agencies, and as such are not the primary subject of this report. This implies that in order to combat smuggling effectively, states need to work closely with federal agencies and support new federal legislation. Below are a few examples of illicit trade activities:

- Direct smuggling into the country.
- Introducing products designated for export only into the US domestic market.
- Buying from websites that do not charge tax.
- Buying products in one state for illegal resale in another. In the U.S., tax free individual purchases for personal use and bootlegging are small problems compared to larger-scale organized smuggling. Small scale evasion tends to spike after a tax increase and then generally fade.
- Buying cigarettes on Native American territories for illegal resale to non-natives.
- Underreporting production or retail sales in a state. Smuggling has a very high profit margin if taxes can be avoided along the supply chain. For example, a distributor can profit from selling tax-free tobacco products to retailers and sub jobber. A retailer can boost revenue by buying tax free cigarettes from smugglers and then selling them to customers at a higher price.

## Innovative Practice Solutions

### Stamping

New technologies are available that make tax stamps larger, highly visible, easy to distinguish from other states' tax stamps, and harder to counterfeit. There also is technology that places stamps on two sides of the packages and under any cellophane wrappers – with the tax stamp coding providing information on what retailers originally purchased and from which distributor or manufacturer it was purchased. This approach can simplify inspections, aid in detecting violations, and facilitate state tobacco tax collections. Tax stamps also could provide a phone number or email address for reporting suspected illegal sales, smuggling, or tax evasion, with rewards for tips that lead to arrests (and new stamps could also include a quit-line phone number for smokers who want to quit). Currently, OTP sold do not generally carry stamps. Stamping helps reduce illicit trade, therefore increasing compliance.

***Innovative Practice Solution:*** Conduct a cost-benefit analysis of introducing a new high technology stamp and work with the industry to determine the feasibility of phasing in nationwide stamping for OTP.

### Tax-Exempt Products

In order to reduce illicit trade in non-stamped products, states could consider requiring state tax-exempt stamps on all legitimate cigarettes and OTP sold in-state that are not subject to the state's tobacco taxes. This could be accompanied by required reporting on all such sales, including amounts sold and to whom, and given to state tax agencies. The stamps could state "for legal tax-exempt sales only." These stamps would make it more difficult to illegally divert tax-exempt cigarettes into non-tax-exempt sales and would provide state officials with important data on the extent of tax-exempt sales and illegal diversion within the state. Several states already have such tax-exempt stamping requirements along with other requirements that facilitate enforcement by establishing that any significant amount of tobacco products found in

the state without the appropriate tax stamp or tax payment are illegal goods (unless in the possession of licensed tobacco product businesses or their delivery services).

Retailers on tribal lands are allowed to sell tobacco products to members of the same tribe free of state tobacco taxes but are not allowed (unless expressly authorized by a state) to sell state-tax-free cigarettes to anyone who is not a tribal member. However, a state's ability to take enforcement action against Native American tribes that fail to collect and remit state taxes on sales to non-members of the tribe are limited because of Native American tribes' sovereign immunity (e.g., states cannot bring tribes into state court to enforce state tax collection laws). Some smokers and smugglers go onto tribal lands to purchase cigarettes and OTP free of any state taxes. To reduce this problem, some states have entered into special compacts or agreements with the tribes located within the states' borders whereby the tribe agrees to collect the state's tax (or a similar tribal tax) on all cigarette or other tobacco product sales on the tribe's lands (whether sold to tribal members or nonmembers) – thereby making the tribal prices comparable to the prices charged elsewhere in the state – and the state agrees that the tribe can keep all of the revenues it raises from charging the state (or tribal) tax. These kinds of state or tribal agreements are important because, otherwise, when a tribe establishes a tribal cigarette tax, it is legally required to collect that tribal tax on top of any state cigarette tax in all sales to non-tribal members, which produces an odd double-taxation problem.

***Innovative Practice Solution:*** Enter into treaties with in-state Native American tribes to reduce or eliminate price disparities. If necessary, require tax-exempt products to carry tax-exempt stamps.

### **Increase Availability of Cigarette and Other Tobacco Products Enforcement Related Information**

Compliance would be increased by states requiring distributors selling cigarettes to retailers to keep and maintain electronic records of amounts sold, to whom, tax-stamp status, *etc.*, and to regularly provide this information to state officials. States also could require better record keeping by retailers such as requiring

- receipts of cigarettes from others (including dates, quantities, from whom received, *etc.*);
- total cigarette sales in the state (with monthly totals); and
- sales of any cigarettes in quantities exceeding a certain threshold (e.g., 2,000 cigarettes or 10 cartons (including dates, quantities, descriptions, to whom sold, *etc.*)).

Alternatively, states could prohibit retail cigarette sales greater than a certain threshold.

***Innovative Practice Solution:*** Require more comprehensive electronic reporting of cigarette and other tobacco product production and distribution activities.

Educating smokers about existing state laws restricting smuggling and tax avoidance would certainly increase voluntary compliance. Most states have laws that prohibit state smokers from bringing in some maximum amount into the state from any other jurisdiction (including nearby

states, tribal lands, military bases, and duty-free shops). While enforcing such laws is difficult, it may be more significant that many smokers do not even know they exist. If smokers were educated about existing law, at least some of them would stop going to other jurisdictions to buy cheaper cigarettes or reduce the size of their purchases. Similarly, many smokers do not know that it is against state law to avoid paying state cigarette taxes by purchasing them over the internet from website sellers that do not collect or pay the tax owed to the state.

***Innovative Practice Solution:*** Develop an out-reach campaign to make sure consumers are aware of the minimum numbers of cartons that trigger smuggling violations or major smuggling penalties. Outreach methods could include

- posting information on state websites,
- income tax publications,
- issuing press releases, and
- running public education announcements.

Making periodic highly publicized “stings” to catch some of the cross-border or internet shoppers who are illegally evading the state cigarette tax might also dampen tax avoidance purchases.

Some states report that they receive most of their leads about illicit tobacco through toll-free hot lines designed to encourage reports of smuggling or tax-avoidance activities. To help increase awareness of such hotlines, states could require state-based sub jobbers, distributors, importers, exporters, and retailers of tobacco products to post prominent signs that provide a toll-free number and email address for reporting anyone suspected of smuggling tobacco products and/or buying or selling smuggled tobacco products. To encourage the reporting of smuggling activities and protect witnesses, states could pass laws to protect the employees of retailers, distributors, sub jobbers, importers, exporters, manufacturers, and delivery services from being fired or otherwise penalized by their employers if the employee notifies authorities about their employers’ smuggling-related wrongdoing or testifies about it in court.

***Innovative Practice Solution:*** Institute and publicize toll-free telephone numbers and ensure that individuals are aware that they are protected under “whistleblower” legislation.

## **Federal Legislation**

The Prevent All Cigarette Trafficking Act (the PACT Act), passed in June 2010, was designed to increase tax compliance of internet and mail order sales of cigarettes and smokeless tobacco products. The law also put safeguards in place to reduce sales to children.

Among other things, the PACT Act requires internet and other mail-order sellers to

- provide each state with monthly reports listing state residents who have purchased cigarettes and smokeless tobacco (including the quantities sold to each and the residents’ mailing addresses), thereby enabling states to go after in-state consumers to collect state taxes owed on the sales;



- affix any related tax stamps before delivering any cigarettes or smokeless tobacco to any customer in a state;
- comply with various state and local laws as if the internet sellers were tobacco product retailers located in the same state as their customers;
- register with the state and make periodic reports to state tax collection officials; and
- check the age and ID of customers both at purchase and at delivery to stop internet cigarette and smokeless tobacco sales to kids.

In addition, the legislation

- subjects illegal internet sellers to strong new penalties,
- allows for the enforcement of the new federal law by the attorney generals of the states, localities, and Native American tribes where the cigarettes are delivered, and
- provides other enforcement tools to enable federal and state enforcement officials to stop the deliveries to consumers of illegally sold cigarettes and smokeless tobacco by noncomplying internet sellers.

The PACT Act was a good first step in reducing tobacco tax evasion by restricting internet tobacco product sales and strengthening other federal laws against contraband tobacco products. The PACT Act creates a more level playing field for cigarettes and smokeless tobacco by

- reducing the cost and price advantage of internet sellers of these products, and
- making sure anti-smuggling provisions and other state laws that apply to in-state retail sellers of cigarettes and smokeless tobacco also apply to internet or mail-order companies that sell cigarettes and smokeless tobacco to persons in the state. This includes all federal and state excise tax collections with tax stamps applied, record-keeping requirements, and applicable penalties, among other provisions.

While states report that the law has been effective with regard to legitimate on-line cigarette and smokeless tobacco sellers, they indicate that it does not go far enough. The effectiveness of the PACT Act would be increased if it were expanded to include all tobacco products.

Other methods to increase compliance nationwide would be for the federal government to require all states to put tax stamps on their cigarettes and OTP, and require special tax stamps or restricted-sale notices on all tobacco products sold free of state taxes on Native American reservations, military bases, and duty-free shops. Alternatively, the federal government could also create nationwide standards for items such as cigarette and tobacco product stamps, cigarette labeling, and record keeping by manufacturers, wholesalers, and retailers.

***Innovative Practice Solutions:*** States could continue to work closely with the federal government to discuss ways to improve the PACT Act. Potential improvements include expanded coverage of the PACT Act to include all tobacco products and have one consolidated point of entry for all reporting information required by the PACT Act.

## **Increase Smuggling Disincentives**

General law enforcement and anti-corruption efforts play an important role in addressing illicit tobacco sales. State and local law enforcement efforts could be coordinated with federal agents who are more likely to prioritize going after the largest most organized operations. From a state perspective, law enforcement could work closely with customs near state borders. Alderman suggests a connection between illicit tobacco and national security, and goes on to recommend that state and local law enforcement agencies could be encouraged to apply for funding opportunities for state and local projects related to national security.

### ***Innovative Practice Solutions***

- Establish or fortify penalties for the manufacture, possession, or sale of counterfeit tobacco tax stamps or counterfeit tobacco products.
- Increase existing fines for cigarette or other tobacco product smuggling. In particular, increase the minimum dollar amounts of existing fines and have no maximum amount so that meaningful fines can be levied against large economic entities involved in smuggling.
- Establish new provisions to allow for the state's seizure of vehicles used in cigarette and tobacco smuggling, putting liens on property for the value of smuggled goods, *etc.* (as with state laws pertaining to illegal drug trafficking).
- State anti-smuggling laws could ensure that retail outlets in the state that buy smuggled cigarettes or knowingly sell smuggled cigarettes will lose their right to sell any cigarettes in the state for some period of time (*e.g.*, from one to ten years depending on the severity of the violation).
- Going beyond just fines and other economic disincentives, state laws could call for jail or prison sentences for persons participating in large smuggling efforts or who are guilty of repeatedly violating the state's anti-smuggling or tax-avoidance laws.

# Appendix G

## Tax Administration Survey Instrument

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### Cigarette and Other Tobacco Products Tax Administration Survey

#### Instructions

For questions where numeric responses are required, if hard data is not available, please provide estimates. If available, can you please provide organizational charts, flow charts, and any other documentation you think might be helpful. Thank you for completing this survey.

#### Definitions

<b>Annual year —</b>	the most recent fiscal year data available.
<b>Assessment —</b>	taxpayer bill assessing tax, penalties, and interest.
<b>Auditor —</b>	a person authorized by your agency to examine accounts and accounting records.
<b>Cigarettes —</b>	include cigarettes and anything else taxed the same as cigarettes, e.g., little cigars.
<b>Claims for credit or refund —</b>	an amended return or a formal request for a credit or refund of tax already paid.
<b>Collector —</b>	a person employed or contracted to collect debt. This can be in-house or an outside agency.
<b>Criminal Investigator —</b>	a person authorized by your agency to carry out a systemic or formal inquiry to discover and examine the facts of an incident or allegation so as to establish the truth. This person may conduct covert investigations. Auditors are excluded from this definition.
<b>FTEs —</b>	full time equivalent employees.
<b>Front-end processing —</b>	initial processing of registration forms, stamp orders, tax returns, etc.
<b>Inspections —</b>	formal examination of the business excluding audit.

**Other tobacco products —**

include little cigars if not taxed like cigarettes, large cigars and cigarillos, premium cigars, loose cigarette tobacco (roll your own), loose dual purpose tobacco, pipe and hookah tobacco, moist snuff/dip tobacco, dry snuff, chewing tobacco, and snus.

**Sub-jobber —**

a person who distributes a tax paid product to retailers for resale or who sells a tax paid product in a vending machine (sometimes called a secondary distributor).

**Background Information**

- 1. Name of your state: \_\_\_\_\_
- 2. Name of your agency: \_\_\_\_\_
- 3. Please provide contact information for any potential follow-up questions.
  - a. Contact person's name: \_\_\_\_\_
  - b. Phone number: \_\_\_\_\_
  - c. Email address: \_\_\_\_\_
- 4. Please describe your current responsibilities.

\_\_\_\_\_

- 5. How long have you worked for the state? \_\_\_\_\_
- 6. How long have you been in this position? \_\_\_\_\_

**Department Budget Information**

- 7. Please identify the fiscal year data you will use to complete this survey?      FY 20\_\_\_\_\_.
- 8. Provide the following information for the following divisions.

	<b>Budget</b>	<b>Total Number of FTEs</b>
<b>a. Front-end processing division</b>	\$	
<b>b. Collections division</b>	\$	
<b>c. Audit division</b>	\$	
<b>d. Criminal Investigations division</b>	\$	

9. Excluding support/administrative staff, please provide the following information.

	All FTEs	Salary Ranges	Cigarette/OTP FTEs	Average Years of Experience
a. Front-end processors				
b. Collectors				
c. Auditors				
d. Criminal investigators				

10. Is any of the revenue generated from enforcement activities deposited directly into a separate enforcement fund? yes no

11. If the answer above is "yes," how much was deposited in the last fiscal year?

\$ \_\_\_\_\_

12. What is the annual budget for compliance-related covert operations?

\$ \_\_\_\_\_

13. Does your state receive any money from the cigarette and other tobacco products industry? yes no

14. If the answer above is "yes," please describe what activities are funded by this revenue stream?

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**Cigarette Specific Questions**

***Licensing***

15. Please provide the following information. **Note:** If your state taxes little cigars as cigarettes, please report data for little cigars as cigarettes.

	<b>Active Licenses</b>	<b>License Fee</b>	<b>Frequency of Renewal</b>
<b>a. Retailer</b>			
<b>b. Sub-jobber</b>			
<b>c. Vending machine</b>			
<b>d. Distributor</b>			
<b>e. Manufacturer</b>			
<b>f. Other</b>			

If applicable, please explain "other." \_\_\_\_\_

16. Does your state require out-of-state cigarette -

	Yes	No
<b>a. manufacturers to hold a license in your state if they ship to distributors or sub-jobbers in your state?</b>		
<b>b. distributors to hold a license in your state if they ship to other distributors in your state?</b>		
<b>c. distributors to hold a license in your state if they ship to retailers in your state?</b>		

17. Does your state issue transporter permits to transport the cigarettes through your state? \_\_\_\_\_yes \_\_\_\_\_ no

18. Who licenses cigarette retailers in your state? (Check all that apply.)

- a. State \_\_\_\_\_
- b. County \_\_\_\_\_
- c. City \_\_\_\_\_
- d. Other \_\_\_\_\_ Specify: \_\_\_\_\_

19. Does your state deny a cigarette license if -

	Yes	No	If yes, how many in the last 5 years?
a. the owner(s) owes any other state taxes regardless of tax type?			
b. the owner(s) has any type of felony conviction?			
c. the owner(s) owe any other state debt?			

Does your state require a bond as part of the licensing requirements?

\_\_\_\_yes \_\_\_\_ no

If yes,

- a. what is the amount of bond? \$ \_\_\_\_\_
- b. have you ever drawn on them? \_\_\_\_yes \_\_\_\_ no
- c. what is the average forfeited bond amount (annually)? \$ \_\_\_\_\_

20. Does your state revoke or hold the following licenses when a cigarette violation occurs?

	Yes	No	If "yes," how many in the last 5 years?
a. Liquor license			
b. Lottery license			
c. Retailer's license			
d. Professional license			
e. Other			

If applicable, please explain "other." \_\_\_\_\_

**Stamp Orders**

21. Check when the payment is due for the stamps.

- a. At time of purchase \_\_\_\_\_
- b. When the stamps are applied \_\_\_\_\_
- c. Other- specify: \_\_\_\_\_

22. What percentage of the payments are made electronically? \_\_\_\_\_%

23. Are electronic payments mandated? \_\_\_\_yes \_\_\_\_ no

24. How often does your state change the cigarette stamp? (Check all that apply.)

- a. Annually \_\_\_\_\_
- b. When you have a tax rate change \_\_\_\_\_
- c. Every two years \_\_\_\_\_
- d. Other – specify \_\_\_\_\_

25. On a scale of 1 to 5, with 5 being the most important, rate the following stamp security features.

- a. Unique serial numbers                    1      2      3      4      5
- b. Color shift                                    1      2      3      4      5
- c. Tagant                                         1      2      3      4      5
- d. Other- specify: \_\_\_\_\_ 1      2      3      4      5

26. Does your state refuse to sell stamps to a licensee who is in default or has violated the cigarette or other tobacco products statute in some way? \_\_\_\_yes \_\_\_\_ no

27. When a claim for credit or refund is filed,

	Yes	No
<b>a. do you require distributors to submit or return damaged stamps?</b>		
<b>b. do you require manufacturer affidavits to be filed?</b>		
<b>c. is the account automatically referred to your Audit area?</b>		

**Other Tobacco Products Specific Questions**

28. Please provide the following information.

	<i>Active Licenses</i>	<i>License Fee</i>	<i>Frequency of Renewal</i>
<b>a. Retailer</b>			
<b>b. Sub-jobber</b>			
<b>c. Vending machine</b>			
<b>d. Distributor</b>			
<b>e. Manufacturer</b>			
<b>f. Other</b>			

If applicable, please explain "other." \_\_\_\_\_



29. Does your state require out-of-state other tobacco product -

	Yes	No
<b>a. manufacturers to hold a license in your state if they ship to distributors or sub-jobbers in your state?</b>		
<b>b. distributors to hold a license in your state if they ship to other distributors in your state?</b>		
<b>c. distributors to hold a license in your state if they ship to retailers in your state?</b>		

30. Who licenses other tobacco product retailers in your state? (Check all that apply.)

- a. State \_\_\_\_\_
- b. County \_\_\_\_\_
- c. City \_\_\_\_\_
- d. Other \_\_\_\_\_ Specify: \_\_\_\_\_

31. Does your state deny a license for other tobacco products taxes if -

	Yes	No
<b>a. the owner(s) owes any other state taxes regardless of tax type?</b>		
<b>b. the owner has any type of felony conviction?</b>		
<b>c. the owner(s) owe any other state debt?</b>		

32. Does your state require a bond as part of the licensing requirements? \_\_\_\_yes \_\_\_\_ no

If yes,

- a. what is the amount of bond? \$ \_\_\_\_\_
- b. have you ever drawn on them? \_\_\_\_yes \_\_\_\_ no
- c. what is the average forfeited bond amount (annually)? \$ \_\_\_\_\_

33. Does your state issue transporter permits to transport other tobacco products through your state?

\_\_\_\_yes \_\_\_\_ no

If yes, which tobacco products? \_\_\_\_\_

34. Does your state revoke or hold the following licenses when other tobacco products tax violations occurs?

	Yes	No	If "yes," how many in the last 5 years.
a. Liquor license			
b. Lottery license			
c. Retailer's license			
d. Professional license			
e. Other			

If applicable, please explain "other." \_\_\_\_\_

35. Does your state have legislation in place for the current fiscal year that requires you to stamp any of the following other tobacco products?

- a. Little cigar \_\_\_yes \_\_\_no
- b. Large cigars and cigarillos \_\_\_yes \_\_\_no
- c. Premium cigars \_\_\_yes \_\_\_no
- d. Loose cigarette tobacco (roll your own) \_\_\_yes \_\_\_no
- e. Loose dual purpose tobacco \_\_\_yes \_\_\_no
- f. Pipe and hookah tobacco \_\_\_yes \_\_\_no
- g. Moist Snuff/dip tobacco \_\_\_yes \_\_\_no
- h. Dry snuff \_\_\_yes \_\_\_no
- i. Chewing tobacco \_\_\_yes \_\_\_no
- j. Snus \_\_\_yes \_\_\_no
- k. Other – please specify: \_\_\_\_\_ \_\_\_yes \_\_\_no

36. If you answered "yes" to any of the components above, did you see, or do you anticipate, a change in compliance as a result of switching to this form of taxation?

- a. \_\_\_ yes, increase in compliance
- b. \_\_\_ yes, decrease in compliance
- c. \_\_\_ no change in compliance

37. If you answered "yes" above and a claim for credit or refund is filed,

	Yes	No
a. do you require distributors to submit or return damaged stamps?		
b. do you require manufacturer affidavits to be filed?		
c. is the account automatically referred to your Audit area?		

**Front-End Tax Administration Compliance Initiatives**

38. Does your state share information with other states, e.g., cross matches of shipments between states?

- a. Cigarette  yes  no
- b. Other tobacco products  yes  no

39. If you answered “yes” above, describe briefly what information your state exchanges?

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40. Does your state cross check shipments from manufacturers with distributor purchases for the following returns?

- a. Cigarette  yes  no
- b. Other tobacco products  yes  no

41. What other strategies does your state use to increase your front-end compliance?

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**Assessment Questions**

42. On average, what amount is assessed and paid annually for the following?

	<i><b>Amount Billed</b></i>	<i><b>Amount Paid</b></i>
<i><b>a. Cigarette</b></i>		
<b>1) Tax</b>		
<b>2) Penalty</b>		
<b>3) Interest</b>		
<i><b>b. Other Tobacco Products</b></i>		
<b>1) Tax</b>		
<b>2) Penalty</b>		
<b>3) Interest</b>		

43. Please provide the following annual information.

	<b>Cigarette</b>	<b>Other Tobacco Products</b>
<b>a. Total number of returns filed</b>		
<b>b. Returns that are assessed a failure to pay penalty</b>		
<b>c. Returns that are assessed a failure to file penalty</b>		
<b>d. Returns that are assessed a failure to pay on time penalty</b>		
<b>e. Returns or stamp orders that are assessed NSF penalties</b>		
<b>f. Returns that are assessed fraud penalties</b>		
<b>g. Returns that are assessed other penalties</b>		
<b>h. Other penalties</b>		

If applicable, please explain "other penalties." \_\_\_\_\_

44. Of those assessments identified above, how many unresolved assessments are forwarded to -

	<b>Cigarette</b>	<b>Other Tobacco Products</b>
<b>a. collectors?</b>		
<b>b. auditors?</b>		
<b>c. criminal investigators?</b>		
<b>d. collectors and auditors?</b>		
<b>e. auditors and criminal investigators?</b>		
<b>f. other?</b>		

If applicable, please explain "other." \_\_\_\_\_

**Audit Questions**

45. Complete the following information below. Please breakdown if possible.

	Annual Number of Audits	Amount Levied	Annual Number of Agreed Audits	Annual Amount of Agreed Audits
<i>Cigarette</i>				
<b>a. Total</b>		\$		\$
<b>b. Retailer</b>		\$		\$
<b>c. Sub-jobber</b>		\$		\$
<b>d. Distributor</b>		\$		\$
<b>e. Manufacturer</b>		\$		\$
<b>f. Other</b>		\$		\$
<i>Other Tobacco Products</i>				
<b>a. Total</b>		\$		\$
<b>b. Retailer</b>		\$		\$
<b>c. Sub-jobber</b>		\$		\$
<b>d. Distributor</b>		\$		\$
<b>e. Manufacturer</b>		\$		\$
<b>f. Other</b>		\$		\$

If applicable, please explain "other." \_\_\_\_\_

46. For audits that are not agreed to in the audit phase, please provide the following annual average information.

	Number of Cases That Go Straight to Hearings	Number of Cases That Agency Prevails	Amount Assessed at the Time of Audit	Percent of Revenue Collected after Hearings Divided by Audit Assessment Amount
<b>a. Cigarettes</b>			\$	%
<b>b. Other Tobacco Products</b>			\$	%

	Number of Cases That Go Straight to Court	Number of Cases That Agency Prevails	Amount Assessed at the Time of Audit	Percent of Revenue Collected after Hearings Divided by Audit Assessment Amount
<b>a. Cigarettes</b>			\$	%
<b>b. Other Tobacco Products</b>			\$	%

	Cases That Move from Hearings to Court	Cases That Agency Prevails	Amount Assessed at the Time of Audit	Percent of Revenue Collected after Hearings Divided by Audit Assessment Amount
<b>a. Cigarettes</b>			\$	%
<b>b. Other Tobacco Products</b>			\$	%

**Compliance and Enforcement Inspections and Activity (excluding audit)**

47. How many inspections are performed annually?

	<b>Cigarette</b>	<b>Other Tobacco Products</b>
<i>Scheduled Inspections</i>		
<b>a. Retailer</b>		
<b>b. Sub-jobber</b>		
<b>c. Distributor</b>		
<b>d. Manufacturer</b>		
<b>e. Other</b>		
<i>Unscheduled Inspections</i>		
<b>f. Retailer</b>		
<b>g. Sub-jobber</b>		
<b>h. Distributor</b>		
<b>i. Manufacturer</b>		
<b>j. Other</b>		

If applicable, please explain "other." \_\_\_\_\_

48. Complete the following information.

<b>Compliance Inspections Performed</b>	<b>Is someone other than a criminal investigator conducting non-audit inspections?</b>	<b>Annual Percentage (inspections/total cigarette or OTP taxpayers)</b>
<i>Cigarette Inspections</i>		
<b>a. Scheduled</b>	Yes _____ No _____	_____ %
<b>b. Unscheduled</b>	Yes _____ No _____	_____ %
<i>Other Tobacco Inspections</i>		
<b>c. Scheduled</b>	Yes _____ No _____	_____ %
<b>d. Unscheduled</b>	Yes _____ No _____	_____ %

49. Does your state use unmarked cars for unscheduled inspections?    \_\_\_yes \_\_\_ no

50. Rank the most frequent type of problems your state finds during **retail** inspections. (1 being most frequent and 7 being the least frequent)

	<b>Cigarette</b>	<b>Other Tobacco Products</b>
<i>Scheduled Inspections</i>		
<b>a. Counterfeit product</b>		
<b>b. Unstamped product</b>		
<b>c. Product with the wrong stamp</b>		
<b>d. Product with counterfeit stamp</b>		
<b>e. Lack of proper invoices</b>		
<b>f. Invalid licenses</b>		
<b>g. Other</b>		
<i>Unscheduled Inspections</i>		
<b>h. Counterfeit product</b>		
<b>i. Unstamped product</b>		
<b>j. Product with the wrong stamp</b>		
<b>k. Product with counterfeit stamp</b>		
<b>l. Lack of proper invoices</b>		
<b>m. Invalid licenses</b>		
<b>n. Other</b>		

If applicable, please explain "other." \_\_\_\_\_

51. Rank the most frequent type of problems your state finds during **sub-jobber** inspections. (1 being most frequent and 5 being the least frequent)

	<b>Cigarette</b>	<b>Other Tobacco Products</b>
<i>Scheduled Inspections</i>		
<b>a. Unstamped product</b>		
<b>b. Product stamp with another state stamp</b>		
<b>c. Lack of proper invoices</b>		
<b>d. Invalid licenses</b>		
<b>e. Other</b>		
<i>Unscheduled Inspections</i>		
<b>f. Unstamped product</b>		
<b>g. Product stamp with another state stamp</b>		
<b>h. Lack of proper invoices</b>		
<b>i. Invalid licenses</b>		
<b>j. Other</b>		

If applicable, please explain "other." \_\_\_\_\_

52. Rank the most frequent type of problems your state finds during **distributor** inspections. (1 being most frequent and 4 being the least frequent)

	<b>Cigarette</b>	<b>Other Tobacco Products</b>
<i>Scheduled Inspections</i>		
<b>a. Counterfeit products</b>		
<b>b. Lack of proper invoices</b>		
<b>c. Invalid licenses</b>		
<b>d. Other</b>		
<i>Unscheduled Inspections</i>		
<b>e. Counterfeit products</b>		
<b>f. Lack of proper invoices</b>		
<b>g. Invalid licenses</b>		
<b>h. Other</b>		

If applicable, please explain "other." \_\_\_\_\_



53. Rank the most frequent type of problems your state finds during **manufacturer** inspections. (1 being most frequent and 3 being the least frequent)

	<b>Cigarette</b>	<b>Other Tobacco Products</b>
<i>Scheduled Inspections</i>		
<b>a. Lack of proper invoices</b>		
<b>b. Invalid licenses</b>		
<b>c. Other</b>		
<i>Unscheduled Inspections</i>		
<b>d. Lack of proper invoices</b>		
<b>e. Invalid licenses</b>		
<b>f. Other</b>		

If applicable, please explain "other." \_\_\_\_\_

54. How many compliance and enforcement inspections result in the following?

	<b>Civil Penalties Only</b>	<b>Criminal Penalties Only</b>	<b>Civil and Criminal Penalties</b>
<i>a. Cigarette</i>			
<b>1) Retailer inspection</b>			
<b>2) Distributor inspection</b>			
<b>3) Sub-jobber inspection</b>			
<b>4) Manufacturer inspection</b>			
<i>b. Other tobacco products</i>			
<b>1) Retailer inspection</b>			
<b>2) Distributor inspection</b>			
<b>3) Sub-jobber inspection</b>			
<b>4) Manufacturer inspection</b>			
<i>c. Unlicensed Individuals</i>			

55. Of the total civil penalties issued, what is the average percentage of the following?

	Fully Paid	Partially Paid	Unpaid	Appealed
<b>a. Cigarette Inspections</b>	%	%	%	%
<b>b. Other tobacco inspections</b>	%	%	%	%
<b>c. Unlicensed individual inspections</b>	%	%	%	%

56. Are your state's criminal investigators sworn officers?  yes  no

57. On average, how many cases are prosecuted annually? \_\_\_\_\_

58. Out of those that are prosecuted, approximately what percent of the time -

- a. do sentences include jail time? \_\_\_\_\_%
- b. are fines issued? \_\_\_\_\_%
- c. are both of the above? \_\_\_\_\_% (a, b, and c should total 100%)

59. Does your state use any type of high-technology alternative to track cigarettes and other tobacco products?

- a. Digitized stamps  yes  no
- b. Bar codes  yes  no
- c. Radio frequency tags  yes  no
- d. "Track and trace"  yes  no
- e. Other  yes  no Please specify - \_\_\_\_\_

If you checked "yes" on any of the above, please elaborate.

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If you checked "no" on any of the above, why not? \_\_\_\_\_

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**Concluding Questions**

60. In your opinion, how do the following factors rank in terms of increasing compliance?

(1=most important, 10 least important)

- a. Stamping product \_\_\_\_\_
- b. Budget resources for audit \_\_\_\_\_
- c. Budget resources for collections \_\_\_\_\_
- d. Budget resources for investigations \_\_\_\_\_
- e. New computer systems \_\_\_\_\_
- f. Increased data capture \_\_\_\_\_
- g. Data matching \_\_\_\_\_
- h. Changes in civil fines and penalties \_\_\_\_\_
- i. Changes in criminal fines and penalties \_\_\_\_\_
- j. Other – please specify: \_\_\_\_\_

61. Is your state considering taxing e-cigarettes?

\_\_\_\_yes \_\_\_\_ no

If “yes,” can you provide us with a brief description of how your state would propose to move forward in taxing this product.

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62. Has your state created or started any new compliance strategies in the last year?

\_\_\_\_yes \_\_\_\_ no

If “yes,” please describe and give statutory sites, if applicable. \_\_\_\_\_

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63. Have there been recent changes in compliance policy or legislation?

\_\_\_\_yes \_\_\_\_ no

If so, please provide information. \_\_\_\_\_

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64. Has your state proposed legislation to increase compliance efforts?

\_\_\_\_yes \_\_\_\_ no

If so, please describe and/or attach any pertinent documents providing this information.

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65. What are the major challenges that your state faces in reducing non-compliance and increasing enforcement of cigarette and other tobacco taxes? \_\_\_\_\_

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66. Minnesota is looking to reduce noncompliance and increase enforcement. Based on your experience and knowledge, what strategies would you advise them to consider?

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67. Who in your state administers youth cigarette and tobacco use prevention programs? Can you please provide contact information?

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**This completes the survey questions.**

**We would like to thank you for your time and effort.**

Should you have questions, please feel free to contact XXXXXXXX XXXXXX at XXX.XXX.XXXX or email us at XXXXXXXX@XXXXXXXXXX.XXX.

# Appendix H

## Statutory License Fees for All Survey States

State	Cigarette Retailer	Cigarette Distributor	Cigarette Sub-Jobber/Wholesaler	Cigarette Manufacturer/Importer
California (1)	\$100	\$1,000	\$1,000	Market share based on Revenue & Taxation Code §22979.2(c)
Illinois	N/A	\$250	\$250	N/A
Iowa	N/A	\$100 first location \$5 for additional locations	N/A	\$0
Michigan	\$100	\$100	\$25	\$100
Montana	\$5	\$50	\$50	N/A
Minnesota (2)	\$0	\$150	\$12	N/A
New Jersey	\$50	\$350	\$250	\$10
New York	\$300	\$1,500	\$1,500	N/A
North Dakota	\$15 combined license with tobacco products	\$25	\$15 Combined license with tobacco products	N/A
Ohio	\$125	\$1,000	\$1,000	N/A
South Dakota	N/A	\$150	\$150	N/A
Virginia (3)	N/A	\$200	N/A	N/A
Wisconsin (2)	N/A	N/A	N/A	N/A

State	Tobacco Retailer	Tobacco Distributor	Tobacco Sub-Jobber	Cigarette Manufacturer/Importer	Vending Machine Operator
<b>California (1)</b>	\$100	\$1,000	\$1,000	\$10,000 one-time fee for chew & moist snuff \$2,000 one-time fee for all other tobacco products. Combined license for all is \$10,000	\$100 per machine
<b>Illinois</b>	N/A	N/A	N/A	N/A	N/A
<b>Iowa</b>	N/A	\$100 per location \$0 if holding a cigarette license also	\$10 per location \$0 if holding a cig license too	N/A	\$100 first location \$5 for additional locations
<b>Michigan</b>	\$10	\$100	\$25	\$100	\$25 for 1st machine plus \$6.25 for each additional
<b>Montana</b>	\$5	\$50	\$50	N/A	\$5 per machine up to 10 machines then flat \$50 fee
<b>Minnesota (2)</b>	N/A	\$37.5	\$10	N/A	N/A
<b>New Jersey</b>	N/A	N/A	N/A	N/A	\$50 per machine
<b>New York</b>	\$300	N/A	N/A	N/A	\$100 per machine
<b>North Dakota</b>	\$15 Combine d license with cigarette	\$25	\$15 Combined license with tobacco products	N/A	N/A
<b>Ohio</b>	\$125	\$1,000	\$1,000	\$0	N/A
<b>South Dakota</b>	N/A	\$150	\$150	N/A	N/A
<b>Virginia (3)</b>	N/A	\$200	N/A	N/A	N/A
<b>Wisconsin (2)</b>	N/A	N/A	N/A	N/A	N/A

Note: Fees have been annualized.

Note: Some cities and counties may charge a retailer license fee.

(1) California retail fee is one time.

(2) Minnesota and Wisconsin fees are paid every 2 years. Figure in table is annual.

(3) Virginia fees are paid every three years. Figure in table is annual fee.

# Appendix I

## Tobacco Taxation: States and Tribal Nations Arrangements<sup>119</sup>

State-level treatment of tobacco products purchased on Native American territories differs throughout the nation. Many states have adopted official agreements/compacts. While the terms of the agreements differ across the states, results suggest that this close cooperation between the state government and the tribe minimizes tax evasion by non-Native American purchasers.

**California** – There is no special cigarette and tobacco product tax exemptions for sales to Native Americans. State tax must be paid and collected on Native American territories on all cigarette and tobacco products.

**Iowa** - Sales by Native Americans to other Native Americans of their own tribe on federally recognized Indian reservations or settlements of which they are tribal members are exempt from the tax. The cigarettes must be purchased by the Indian seller with the tax included in the purchase price. The tax exemption is allowed to the Indian purchaser by the purchaser's filing a claim for refund of the tax paid or to the tribe of which the Indian purchaser is a member by the tribe's filing a claim for refund of the tax paid by the tribe on cigarettes sold to the Indian purchaser.

**Michigan** - Ten tribes have entered into an agreement with the state. The agreement subjects all tobacco products sold within the Agreement Area to the provisions of the Tobacco Products Tax Act, except as provided in this agreement. Briefly, the agreement states that the tribes may purchase a quantity of tax exempt tobacco administered by either the quota method or the refund method. The *quota method* allows the tribe to purchase an annual quota of tobacco products without the imposition of the state tax. The *refund method* allows for all tobacco products for resale to be purchased from any state licensed wholesaler with the tax prepaid.<sup>120</sup>

**Minnesota** – Minnesota has entered into agreements with all but one tribe. The state collects all state and tribal taxes covered by the agreements and make payments to the tribal government from the funds collected. The tax agreements do not have expiration dates and either party can seek to amend or cancel it. The agreements allow MDOR to seek tribal government assistance with collecting debts and auditing. Tribes receive 100 percent refund for the tax paid by tribal members and fifty percent refund for taxes paid by non-tribal members.

**New York** – The New York cigarette tax is not imposed on sales to qualified Native Americans for their own use and consumption on qualified Native American territories. The tax is imposed on all cigarettes sold on Native American territories to non-members of the tribe and to non-natives. Evidence of this tax shall be by means of an affixed cigarette tax stamp. Tribes may elect to participate in a tax exemption coupon system which provides a mechanism for the collection of the tax imposed on cigarette sales on qualified Native American territories to non-members and non-natives. If a tribe does not elect to participate in the tax exemption coupon system, cigarette sellers can purchase adequate quantities of tax-exempt cigarettes for the personal use and consumption of qualified members of the tribe in their tribes' qualified Native American territory.<sup>121</sup>

**North Dakota** - Wholesalers or distributors are not required to collect the excise tax on sales of cigarettes to enrolled tribal members who have been granted authority by the tribe to conduct retail sales of cigarettes within the boundaries of the Native America territory. These sales must be reported to the state as exempt sales. When a distributor makes an untaxed cigarette sale to an enrolled tribal member, the distributor must obtain from the tribal member, their name, Social security number, address, tribe name, their tribal enrollment number, and certification that they have been granted authority from the tribe to conduct cigarette sales activity within the boundaries of the Indian country.<sup>122</sup>

**Oklahoma** - Tribes have signed Compacts with the state. The Compacts indicate the tax rate for any cigarette sales made to both tribal members and non-tribal members. If a tribe has not signed a compact and they have tobacco shops, they are given a no-tax allocation outlining the amount of tax free cigarettes that can be sold. These can only be sold to tribal members of non-compact status tribes. This allocation is based on the amount of tribal smokers and the tribal population. Any other cigarettes sold must have the full tax rate stamp affixed. The tribal shops have a State issued "tribal stamp" affixed to cigarette packs sold in their shops. These are sold to tribal members as well as non-tribal members. The current compacts have a rebate program with the tribes. The amount of rebate varies from Compact to Compact.

**South Dakota** – The state cigarette tax is applied at the full rate to cigarettes sold on tribal land for cigarettes sold for consumption by tribal members. The full state cigarette tax is also applied to native cigarettes sold on tribal land to non-tribal members. Tax rebate agreements providing for a fixed percentage of the total annual state and tribal tax are in place and vary from tribe to tribe. Proceeds are remitted to the Indian tribe in lieu of the exact amount of the revenue collected as a result of the imposition of tribal taxes. Details of these agreements are not public record.

**Wisconsin** – Under Wisconsin's Cigarette Tax Agreements all cigarettes are stamped with distinctive Tribal tax stamps by WDOR permitted Cigarette Distributors for sales to a Tribe's authorized tribal retailers. Non-authorized retailers on a reservation/trust land must purchase regular state tax-stamped cigarettes and are taxed at the full rate. Tribes may file a refund claim for 70 percent of the tax on all stamped cigarettes purchased by their authorized tribal retailers for over-the-counter sales to consumers (*i.e.*, non-tribal members, tribal members on their



reservation/trust land(s), and tribal members from other tribes/reservations). In addition to the 70 percent refund, tribes may file a refund claim for 30 percent of the remaining tax each quarter. This refund is based on a number of factors, including the tribe's population of enrolled tribal members residing on their reservation, the current cigarette tax, and the Wisconsin per capita cigarette consumption as reported by Orzechowski & Walker's Tax Burden on Tobacco.

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# Appendix J

## Fines, Penalties, Criminal Charges, Sanctions, and Interest in Minnesota Compared to Selected Survey States

This appendix is broken into several sections and provides a side by side view of the penalties, criminal charges, sanctions, and interest that may be imposed by the states included within the survey.

The sections are broken further divided by monetary penalties, criminal charges (that may or may not include penalties), sanctions, interest, and unique penalties.

The unique penalty section contains civil penalties, criminal charges, and sanctions that JD Michael found in three or fewer states that were surveyed.

It should be noted that it is possible for a particular type of non-compliance with a law to be listed in multiple sections because some state may only impose a penalty while others will impose a sanction, criminal charges, or all three types of methods to promote compliance.

If JD Michael did not find a specific penalty, criminal charge, or sanction for a violation of the law, a notation was made indicating that nothing specific for that type of violation was found. However, it is possible that a penalty, criminal charge, or sanction may exist because some state statutes do not list a specific penalty, criminal charge, or sanction for a particular violation but may have generic “catch all” provisions that simply state, for example, “A person who violates a provision of the act for which a criminal punishment is not otherwise provided is guilty of a misdemeanor, punishable by a fine of not more than \$1,000 or 5 times the retail value of the tobacco products involved, whichever is greater, or imprisonment for not more than 1 year, or both”. The states where JD Michael found these types of statements are listed in the Unique Penalties Section.

Based on the report’s findings in conjunction with feedback from MDOR, the states highlighted in gray have a particular penalty, criminal charge, or sanction that MDOR could consider adding or modifying in Minnesota Statute Chapter 297F Cigarettes And Tobacco Taxes or the Minnesota Statute Chapter 609 Criminal Code.

**Note:** The language used in this appendix summarizes each state’s statute and is not a direct quote of the law.

# Monetary Penalties

These are penalties that may be imposed by tax departments without the need for prosecution in a court of law.

## Failure to Pay Tax

Generally, this penalty is imposed if the tax is not paid within the time specified for payment. This penalty is added to the amount required to be shown as tax. This penalty is typically referred to as a late payment penalty.

**Minnesota:** The penalty is 5 percent of the tax not paid on or before the date specified for payment of the tax if the failure is for not more than 30 days, with an additional penalty of 5 percent of the amount of tax remaining unpaid during each additional 30 days or fraction of 30 days during which the failure continues, not exceeding 15 percent in the aggregate [Minn. Stat. 297F.19 Subd. 2].

**California:** 10 percent of the amount of tax due [California Revenue and Taxation Code, Section 30171 (Distributor), Section 30190 9(e) (EFT) Section 30190 (f) Section 30281 (a) and Section 30264].

**Illinois:** Penalty is based on the number of days the tax required to be shown due on the return is late.

- 1 - 30 days: 2 percent
- 31 + days: 10 percent.

After the initiation of an audit or investigation, a late-payment penalty is as follows:

- 15 percent if the tax is paid within 30 days
- 20 percent if tax is paid more than 30 days after the issuance of the audit-prepared amended return at the conclusion of the audit.

The 20 percent penalty rate also applies to an amount paid before the expiration of the 30-day period if paid under protest or if a claim for credit or refund of that amount is subsequently filed [Illinois 35 ILCS 735/3-3].

**Iowa:** 5 percent [Iowa Code, §421.27 (2)].

**Michigan:** 5 percent of the tax shall be added if the failure is for not more than 2 months, with an additional 5 percent penalty for each additional month or fraction of a month during which the failure continues or the tax and penalty is not paid, to a maximum of 25 percent [MIC 205.24(2)].

- New Jersey:** No specific penalty found.
- New York:** 50 percent of the amount of tax due plus 1 percent of the amount due for each month [New York Code, Article 20 § 481(B)].
- North Dakota:** 5 percent or \$5, whichever is greater [North Dakota Century Code, 57-36-09 (cigarettes) 57-36-26 (cigars, pipe tobacco, and OTP)].
- Ohio:** Dealers cigarette discount can be denied (after 10 days notice) on further purchase of cigarette tax stamps or impressions for such period of time as the Department of Taxation may determine in each case when the dealer violates the cigarette act, including for failure to file or failure to pay [O.R.C. 5703-15-06].
- Report of cigarettes purchased without proper stamp (excluding MSA report) - \$1 per day [O.R.C. 5743.03(E)].
- Wholesale dealer or retailer fails to pay or fails to collect state and local taxes, up to 30 percent penalty [O.R.C. 5743.081].
- Distributor OTP - \$50 or 10 percent of the tax due, whichever is greater [O.R.C. 5743.52].
- South Dakota:** Considers their form of a late payment penalty to be in the form of an interest charge at the rate of 1.25 percent (.0125) and it applies to each month or part thereof to any tax unpaid after the due date (a minimum of \$5 interest is due the first month) [SDCL 10-59-6].
- Virginia:** 5 percent if the failure file or pay is for not more than 1 month, with an additional 2 percent for each additional month, or fraction thereof, during which the failure continues, not to exceed 20 percent. However, there is a minimum penalty of \$10 that applies whether or not any tax is due. [Code of Virginia § 58.1-1021.04 (Cigarette and Tobacco -Roll your own)].
- Wisconsin:** Considers their form of a late payment penalty for cigarette inventory tax to be in the form of a delinquent interest charge at the rate of 1.5 percent per month or fraction of a month from the date the tax is due until the date when the tax is paid [Wis. Stat. 139.315(5) (Cigarette Inventory Tax)].

## Failure to Make and File Return

Generally, this penalty is imposed if a taxpayer fails to make and file a return within the time prescribed, including an extension. A penalty of a certain percent of the amount of tax not timely paid is added to the tax. This penalty is typically referred to as a late filing penalty.

- Minnesota:** The maximum penalty for paying and filing late is 20 percent. If the filer knowingly files a false or fraudulent return, or intentionally does not file to avoid paying tax [Minn. Stat. 297F.19 Subd. 3].
- California:** 10 percent of the amount of the tax due [California Revenue and Taxation Code, Section 30281(b), Section 30221, Section 30190 (d) (EFT)].
- Illinois:** Penalty is the lesser of \$250 or 2 percent of the tax required to be shown due on the return without regard to timely payments or credits. If the return is timely filed but cannot be processed, the taxpayer will have 30 days to correct the return before penalty is due.
- If the return is not filed within 30 days after receiving notice of non-filing, an additional penalty will be imposed equal to the greater of \$250 or 2 percent of the tax shown due on the return without regard to timely payments. The additional penalty may not exceed \$5,000. The penalty will be assessed even if there is no tax due [Illinois 35 ILCS 735/3-3].
- Iowa:** 10 percent of the tax shown due or required to be shown due. [Iowa 421.27(1)]. Stamps shall not be provided to the cigarette distributor until all returns and reports are filed properly and all tax [Iowa Code, §453A.31 (b)].
- Michigan:** 5 percent of the tax shall be added if the failure is for not more than 2 months, with an additional 5 percent penalty for each additional month or fraction of a month during which the failure continues or the tax and penalty is not paid, to a maximum of 25 percent [MCL 205.24(2)].
- New Jersey:** No specific penalty found.
- New York:** 10 percent of tax due plus 1 percent for each month up to 30 percent. [New York Code, Article 20 § 481(1) (a) (i) (A)]. If the return is not filed within 60 days of the due date for filing, the penalty imposed is the lesser of \$100 or 100 percent of the amount required to be shown as tax on the return [New York Code, Article 20 § 481(1)(a)(i)(C)].
- North Dakota:** 5 percent or \$5, whichever is greater [North Dakota Century Code, 57-36-09 (Cigarette), 57-36-26 (OTP)].

**Ohio:** Not more than \$250 for each month [O.R.C. 5743.03]. Dealer's cigarette discount also can be denied (after 10 days notice) on further purchase of cigarette tax stamps or impressions for such period of time as the Department of Taxation may determine in each case when the dealer violates the cigarette act, including for failure to file or failure to pay [O.R.C. 5703-15-06]. Wholesale dealer or retailer fails to file return, up to 30 percent penalty [O.R.C. 5743.081].

Distributor OTP - \$50 or 10 percent of the tax due, whichever is greater [O.R.C. 5743.52].

**South Dakota:** 10 percent of the tax or \$10 whichever is greater [SDCL 10-59-6].

**Virginia:** 5 percent if the failure to file or pay is for not more than 1 month, with an additional 2 percent for each additional month, or fraction thereof, during which the failure continues, not to exceed 20 percent. However, there is a minimum penalty of \$10 that applies whether or not any tax is due. [Code of Virginia § 58.1-1021.04 (Cigarette and Tobacco - "roll your own")].

A cigarette stamping agent who fails or refuses to file a report between the first and twentieth of each month, covering all revenue stamps the stamping agent affixed to cigarettes during the preceding month, may be subjected to an additional penalty which includes revocation of the permit to affix revenue stamps and a penalty of \$500 for each day after the due date that an agent fails or refuses to file the report [Code of Virginia § 58.1-1003 (E) (Cigarette)].

A stamping agent who fails to file a report between the first and twentieth of each month, covering the purchase or receipt by them of all cigarettes during the preceding month may be assessed an additional penalty of \$250, for each failure or refusal to file the report in the manner and time allowed. Revocation of a stamping permit for up to 1 year for failing to file more than one of the required reports in a timely manner in any calendar year. After such time, the stamping agent must reapply for a stamping permit.

Cigarette Manufacturers – The department may impose a civil penalty not to exceed \$5,000 against any for such failure or refusal. Each failure or refusal shall constitute a separate violation [Code of Virginia § 58.1-1008.1].

**Wisconsin:** Late- filing fee -\$10 [Wis. Stat. 139.38(5) (Cigarette), 139.82(5) (Tobacco), 139.315(4) (Cigarette Inventory Tax)].

*Late-filing penalty* – 5 percent of the amount of tax due with the return with an additional 5 percent for each additional 30 days or fraction thereof up to a maximum of 25 percent is imposed, [Wis. Stat. 139.85 (2) (Tobacco)]

If any tobacco products use tax return is not filed within the time specified, a penalty of 5 percent of the tax, with an additional 5 percent for each additional 30 days or fraction thereof up to a maximum of 25 percent is imposed, but the penalty for failing to file timely shall not be less than \$10 [Wis. Stat. 139.78 (3) (Tobacco Products Use Tax)].

If the cigarette use tax imposed is not paid when due, it becomes delinquent and the person liable for it shall pay, in addition to the tax, a penalty of \$25 for each 200 cigarettes. Interest on the delinquent tax and penalty shall accrue at the rate of 1.5 percent per month or each fraction of a month from the date the tax became due until paid. [Wis. Stat. 139.33 (3) (Cigarette Use Tax)]

### **Negligence or Intentional Disregard of Law or Rules**

Generally, this penalty is assessed if part of an additional assessment is due to negligence or intentional disregard of the provisions of the applicable tax laws or rules, but without intent to defraud.

**Minnesota:** An amount equal to 10 percent of the additional assessment will be added to the tax [Minn. Stat. 297F.19 Subd.5].

**California:** 10 percent of the amount of a deficiency if it is due to negligence or intentional disregard of statutes or administrative rules. [California Revenue and Taxation Code, Section 30204].

**Iowa:** No specific penalty. See False or Fraudulent Return; Evasion Penalty.

**Illinois:** 20 percent of the deficiency attributable to the negligent act or omission [Illinois 35 ILCS 735/3-5].

**Michigan:** Negligence, but without intent to defraud, \$10 or 10 percent of the total amount of the deficiency in the tax, whichever is greater [MCL 205.23(3)]. Intentional disregard but without intent to defraud, \$25 or 25 percent [MCL 205.23 (4)].

**New Jersey:** No specific penalty found.

**New York:** No specific penalty found.

**North Dakota:** No specific penalty found.

**Ohio:** No specific penalty found.



- South Dakota:** No specific penalty found.
- Virginia:** No specific penalty found. See False or Fraudulent Return; Evasion Penalty.
- Wisconsin:** 25 percent of the tax if there was negligence in filing a return [Wis. Stat. 139.44(12) (Cigarette), 139.85(1) (Tobacco)].

## **False or Fraudulent Return; Evasion**

Generally if a person files a false or fraudulent return, or attempts in any manner to evade or defeat a tax or payment of tax, there is imposed on the person a penalty equal to a percent of the tax due for the period to which the return relates, less amounts paid by the person on the basis of the false or fraudulent return.

- Minnesota:** A penalty is imposed equal to 50 percent of the tax due for the period to which the return relates, less amounts paid by the person on the basis of the false or fraudulent return [Minn. Stat. 297F.19 Subd. 7].
- California:** 25 percent [California Revenue and Taxation Code, Section 30224 and 30205].
- Illinois:** 50 percent of the deficiency attributable to the fraudulent act or omission [Illinois 35 ILCS 735/3-6].
- Iowa:** 75 percent for willful failure to file or deposit with intent to evade tax, or in case of willfully filing a false return or deposit form with the intent to evade tax, in lieu of the penalties [Iowa Code, §421.27 (4)].
- Additional penalties can apply for false or incomplete reports. For a first violation, \$200, second violation within three years, \$500, third or subsequent violation within three years, \$1,000 [Iowa Code, §453A.31 (1) (b)].
- Michigan:** Fraudulent intent to evade a tax is 100 percent of the deficiency [MCL 205.24(5)].
- New Jersey:** No specific penalty found.
- New York:** Penalty of two times the amount of tax due, plus (B) interest on such unpaid tax [New York Code § 481(iv) (A)].
- North Dakota:** No specific penalty found.
- Ohio:** No specific penalty found.

**South Dakota:** No specific penalty found.

**Virginia:** A penalty of 100 percent of the tax due [Code of Virginia § 58.1-1812(A)].

50 percent of the amount of the proper OTP tax for willful failure to file a return with the intent to defraud [Code of Virginia § 58.1-1021.04 (OTP)].

Where willful intent exists to defraud the Commonwealth of the cigarette tax, there will be a penalty of \$25 per pack, up to \$250,000 for cigarettes [Code of Virginia, § 58.1-1017 (A)].

**Wisconsin:** An amount equal to the tax that the person evaded or attempted to evade may be charged [Wis. Stat. 139.44 (2) (Cigarette), 139.315 (6) (Cigarette Inventory Tax), and 139.85 (1) (Tobacco)].

## **Untaxed Cigarettes or Other Tobacco Products**

Generally, this is a “use” penalty that is imposed for bringing unstamped or untaxed product into a state but it can be imposed on the unlawful possession of untaxed cigarettes that are acquired within the state or on counterfeit cigarettes.

**Minnesota:** See Criminal Penalties Section.

**California:** See Criminal Penalties Section.

**Illinois:** Cigarette Use Tax – Possessing not less than 10 and not more than 100 packages of contraband cigarettes contained in original packages is liable to pay a penalty of \$20 for each such package of cigarettes [Illinois 35 ILCS 135/25b (Cigarette Use Tax)].

Cigarette Tax – Possessing not less than 10 and not more than 100 packages of contraband cigarettes contained in original packages is liable to pay a penalty of \$10 for each such package of cigarettes [Illinois 35 ILCS 130/18c (Cigarette Tax)].

More than 100 packages of contraband cigarettes contained in original packages is liable to pay a penalty of \$25 for each such package of cigarettes in excess of 100 packages [Illinois 35 ILCS 130/18b (Cigarette Tax)] [Illinois 35 ILCS 135/25a (Cigarette Use Tax)].

**Iowa Code:** For possession or delivery of unstamped cigarettes

**First violation –**

- Flat penalty of \$200 for more than 40 but not more than 400 unstamped cigarettes.
- Flat penalty of \$500 for more than 400 but not more than 2000 unstamped cigarettes.
- Per pack penalty of \$25 applies if there are more than 2000 unstamped cigarettes.

**Second violation in three years –**

- Flat penalty of \$400 for more than 40 but not more than 400 unstamped cigarettes.
- Flat penalty of \$1,000 for more than 400 but not more than 2000 unstamped cigarettes.
- Per pack penalty of \$35 applies if there are more than 2000 unstamped cigarettes.

**For a third or subsequent violation within three years**

- Flat penalty of \$600 for more than 40 but not more than 400 unstamped cigarettes.
- Flat penalty of \$1,500 for more than 400 but not more than 2000 unstamped cigarettes.
- Per pack penalty of \$45 for more than 2000 unstamped cigarettes. [Iowa Code, §453A.31 (1) (a)] [Iowa Code §453A.11].

**Selling unstamped cigarettes in a vending machine in excess of 40 cigarettes**

[Iowa Code, 453A.36 (1)]

- For a first violation, \$300 with automatic 14-day suspension if civil penalty not paid. [Iowa Code, §453A.22 (2) (a)].
- For a second violation within a period of 2 years, \$1,500 or 30-day suspension (retailer's preference) [Iowa Code, §453A.22 (2) (b)].
- For a third violation within a period of 3 years, \$1,500 and automatic 30-day suspension [Iowa Code, §453A.22 (2) (c)].
- For a fourth violation within a period of 3 years, \$1,500 and automatic 60-day [Iowa Code, §453A.22 (2) (d)].
- For a fifth violation within a period of 4 years, automatic 1-year revocation [Iowa Code, §453A.22 (2) (e)].

**Unstamped or tax not paid (discovered through audit)**

- 5 percent of the tax due [Iowa Code §453A.28] [Iowa Code 421.27 (2)].

- Michigan:** Civil fine of not more than \$100 when a person, who possesses, acquires, transports, or offers for sale contrary to the act
- 180 or more, but not more than 599, cigarettes,
  - tobacco products with an aggregate wholesale value of \$25 or more but less than \$50, or
  - 180 or more, but not more than 599, counterfeit cigarettes, counterfeit cigarette papers, gray market cigarettes, or gray market cigarette [MCL 205.428 (12)].

**New Jersey:** Possession of untaxed cigarettes, failure to remit tax due, \$250 penalty per carton (civil offense).<sup>123</sup> Not more than \$1,000 for each individual carton of unstamped or illegally stamped cigarettes in the dealer's possession, which penalty shall be sued for and recovered [N.J. Rev. Stat. 54:40A-25 (602)].

**New York:** \$150 for each carton (1,000 cigarettes) in excess of 5 cartons [New York Code, Article 20 § 481].

Knowing possession/control unstamped cigarettes

- >1,000 but <=5,000 - \$30 - \$200
- >5,000 but <= 20,000 - \$75 - \$200
- >20,000 - \$100 - \$200 [New York Code, Article 20 § 481]

Untaxed tobacco

Each 50 cigars or pound of tobacco

- >50 cigars \$75 - \$7,500 max
- >1 pound - \$75 - \$7,500 max
- >500 cigars - \$150; - \$7,500 max
- >10 pounds - \$150; \$- \$7,500 max [New York Code, Article 20 § 481]

Untaxed tobacco in possession of or under the control of any tobacco products dealer or distributor

Each 50 cigars of fraction thereof or each pound of tobacco or fraction thereof

- >50 cigars - \$75; \$15,000 max.
- >250 cigars - \$150; \$15,000 max
- 1 pounds - \$75; \$15,000 max
- 5 pounds - \$150; \$15,000 max

Knowing/possession or control of tobacco products on which the tax has not been paid or assumed by a tobacco products distributor or dealer

- >250 cigars - \$25 - \$100
- >5 pounds - \$25 - \$100

- >500 cigars - \$50 - \$200; 1,000 max
- >10 pounds - \$50 - \$200; 1,000 max
- >50 cigars - \$25 - \$100; \$20,000 max
- >1 pound - \$25 - \$100; \$20,000 max
- >250 cigars - \$50 - \$200; \$20,000 max
- >5 pounds - \$50 - \$200; \$20,000 max [New York Code, Article 20 § 481.]

**North Dakota:** N/A

**Ohio:** No specific penalty found.

**South Dakota:** Any person, who possesses 2,000 or more cigarettes that do not bear a tax stamp indicating that the South Dakota cigarette tax has been paid, must pay the tax imposed plus a penalty equal to 10 percent of the total tax due [SDCL 10-50-6].

**Virginia:** Sale of unstamped cigarettes by wholesale dealers – up to \$500 per pack of cigarettes [Code of Virginia, § 58.1-1010].

Failure of a wholesale dealer to properly affix stamps – \$2.50 per pack, up to \$500, for the first violation within a 36-month period; \$5 per pack, up to \$1,000, for the second violation within a 36-month period; and; \$10 per pack, up to \$50,000, for the third and any subsequent violation within a 36-month period [Code of Virginia, § 58.1-1013].

Sale, purchase, possession, etc., of unstamped cigarettes for purpose of evading tax – \$2.50 per pack, up to \$500, for the first violation within a 36-month period; \$5 per pack, up to \$1,000, for the second violation within a 36-month period; and \$10 per pack, up to \$50,000, for the third and any subsequent violation within a 36-month period.

In addition, where willful intent exists to defraud the Commonwealth of the tax, a civil penalty of \$25 per pack, up to \$250,000 will be imposed [Code of Virginia, § 58.1-1017 (A)].

**Wisconsin:** If the use tax is not paid when due, a delinquent interest of 1.5 percent of the amount of use tax due per month and a penalty of \$25 per each 200 cigarettes (1 carton) may be charged [Wis. Stat. 139.33 (3)].

## Operating Without a License

Generally, operating without a license can include someone who has never received a license or someone who is operating on a revoked or suspended license.

**Minnesota:** No specific penalty found.

**California:** For unlicensed cigarette and tobacco products – Board estimates the amount distributed, calculates the tax, and then charges 25 percent of the amount of tax or \$500, whichever is greater [California Revenue and Taxation Code, Section 30211].

**Illinois:** No specific penalty found.

**Iowa:** First violation, \$200, second violation within 3 years, \$500, and third or subsequent violation within 3 years, \$1,000 [Iowa Code 453A.31 (1) (b)].

**Michigan:** Person held liable for the tax imposed, plus a penalty of 500 percent of the amount of tax due under this act [MCL 205.428 (1)].

**New Jersey:** Not more than \$1,000, which penalty shall be sued for, and each day that the business is engaged in or conducted is deemed a separate offense [N.J. Rev. Stat. 54:40A-24 (601.a)].

**New York:** Retailers – first violation, \$5,000 - \$25,000, second or subsequent within 3 years, \$10,000 - \$35,000 [New York Code, Article 20 § 480-3a].

Owners and operators of vending machines through which cigarettes or tobacco products are sold – first violation, \$750 - \$2,000, second or subsequent within 3 years, \$2,000 - \$6,000 [New York Code, Article 20 § 480-3b].

**North Dakota:** No penalty found (only that it is unlawful to sell without a license).

**Ohio:** Up to \$1,000 for anyone distributing OTP without a license [O.R.C. 5743.61(E) (1)].

**South Dakota:** No penalty found. See Criminal Penalties.

**Virginia:** Cigarettes sold when a permit is revoked – A penalty of \$250 per pack of cigarettes sold may also be imposed if the stamping permit has been revoked. Each pack of cigarettes sold is a separate offense. Where willful intent exists the penalty is \$2,500 per pack [Code of Virginia § 58.1-1008].

Any person other than an authorized holder who possesses, with intent to distribute – \$2.50 per pack, but no more than \$5,000, for a first offense; \$5 per pack, but no more than \$10,000, for a second such offense committed within a 36-month period; and \$10 per pack, but no more than \$50,000, for a third or subsequent such offense committed within a 36-month period [Code of Virginia, § 58.1-1017.1].

**Wisconsin:** Operating without a license - not more than \$100 or less than \$25 for the first offense and not more than \$200 or less than \$25 for the second or subsequent offense. If upon such second or subsequent violation, the person is personally guilty of a failure to exercise due care to prevent the violation, the person is fined not more than \$300 or less than \$25 or imprisoned not exceeding 60 days or both [Wis. Stat. 134.65 (5)].

## Criminal Charges and Penalties

Criminal penalties are penalties that can be imposed when violations are prosecuted in a court of law and can involve fines and jail time.

### Failure to File or Pay

This is a criminal penalty that is generally imposed if a taxpayer fails to make and file a return and pay the tax within the time prescribed, including an extension.

- Minnesota:** Failure to file is a misdemeanor (imprisonment for not more than 1 year or to payment of a fine of not more than \$3,000, or both [Minn. Stat. 609.03 and 297F.20 sub 1].
- Failure to pay or to collect and remit a tax, when required, is a misdemeanor (imprisonment for not more than 1 year or to payment of a fine of not more than \$3,000, or both [Minn. Stat. 609.03]). [Minn. Stat. 297F.20 sub 1].
- California:** Misdemeanor, fine up to \$1,000 for each offense [California Revenue and Taxation Code, Section 30471].
- Illinois:** When the tobacco products tax amount due is under \$300, any distributor who fails to file a return is guilty of a Class 4 felony. When the tobacco products tax amount due is over \$300, any distributor who fails to file a return is guilty of a Class 3 felony [Illinois 35 ILCS 143/10-50 (Tobacco Products Tax)].
- Iowa:** OTP – Any person who fails or refuses to transmit to the director the required reports or whoever refuses to permit the examination of the records by the director shall be guilty of a serious misdemeanor, up to 1 year in jail and a fine of between \$315 and \$1,875. [Iowa Code Title XVI, Subtitle 3, Chapter § 903.1.] [Iowa Code, §453A.45]
- Michigan:** No specific criminal penalty found.
- New Jersey:** No specific criminal penalty found.
- New York:** No specific criminal penalty found. See False or Fraudulent Returns.
- North Dakota:** No specific criminal penalty found.
- Ohio:** No specific criminal penalty found.
- South Dakota:** No specific criminal penalty found.



**Virginia:** Cigarette Manufacturers – Any manufacturer who fails or refuses to file the required report or who upon request by a duly authorized agent or representative of the department fails or refuses to allow an audit or inspection of records is guilty of a Class 2 misdemeanor [Code of Virginia § 58.1-1008.1].

**Wisconsin:** A person who fails to collect and remit tobacco tax may be fined not more than \$10,000 or imprisoned for not more than 9 months or both [Wis. Stat. 139.85(1)].

### **Knowingly Failure to File or Pay**

This is a criminal penalty that is generally imposed if a taxpayer knowingly, rather than accidentally, inadvertently, or negligently, fails to file a return or pay the tax when required within the time prescribed, including an extension. Some states call this a penalty for evasion.

**Minnesota:** Failure to file is a gross misdemeanor. Failure to pay or to collect and remit a tax is a gross misdemeanor (imprisonment for not more than 1 year or payment of a fine of not more than \$3,000, or both [Minn. Stat. 609.03 and 297F.20 sub 2]).

**California:** Felony offense when the amount of tax liability aggregates \$25,000 or more in any 12-consecutive-month period. Each offense shall be punished by a fine of not less than \$5,000 and not more than \$20,000, or imprisonment for 16 months, 2 years, or 3 years, or by both the fine and imprisonment in the discretion of the court [California Revenue and Taxation Code, Section 30480].

**Illinois:** Cigarette - Class 4 Felony [Illinois Cigarette 35 ILCS 130/25].

OTP - when the tobacco products tax amount due is under \$300, Class 4 felony. When the tobacco products tax amount due is over \$300, Class 3 felony [Illinois 35 ILCS 143/10-50 (Tobacco)].

**Iowa:** Serious misdemeanor and up to 1 year in jail and a fine of between \$315 and \$1,875. Imposed when a person knowingly attempts to evade the tax or knowingly aids or abets in the evasion or attempted evasion of the tax or who knowingly operates without a distributor/sub-jobber license [Iowa Code Title XVI, Subtitle 3, Chapter § 903.1.] [Iowa Code, §453A.50 (1)].

**Michigan:** No specific criminal penalty found.

**New Jersey:** No specific criminal penalty found.

**New York:** Cigarette and tobacco products tax – 10,000 cigarettes or more; 22,000 cigars or more; 440 pounds of tobacco or more; or has previously been convicted two or more times of a violation shall be guilty of a class E felony of 1-4 years imprisonment, fine \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher.

If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense [New York Pen. §70.00(e) and § 80.00 and §80.10] [New York Code, Article 37 § 1814].

**North Dakota:** No specific criminal penalty found.

**Ohio:** First conviction – felony of the fourth degree [O.R.C. 5743.99(B)], 6-18 months imprisonment [O.R.C. 2929.14(A) (b) (4)] and maximum fine of \$5,000 [O.R.C. 2929.18(A) (3) (a)].

Second conviction – felony of the second degree [O.R.C. 5743.99(B)], 2-8 years [O.R.C. 2929.14(A) (2)] and maximum fine of \$15,000 [O.R.C. 2929.18(A) (2) (c)].

**South Dakota:** No specific criminal penalty found.

**Virginia:** Sale, purchase, possession, receives, or possesses cigarettes for purpose of evading tax –

< 500 packages of cigarettes –

- First violation – Class 1 misdemeanor up to 12 months, up to \$2,500, or both [Code of Virginia, Title 18.2 § 18.2-11(a)].
- Second or subsequent violation – Class 6 felony, 1-5 years, or in the discretion of the jury or the court trying the case without a jury, confinement in jail for not more than 12 months and a fine of not more than \$2,500, either or both [Code of Virginia, Title 18.2 § 18.2-10. (f)].

500 or more packages of cigarettes –

- First violation, Class 6 felony, 1-5 years, or in the discretion of the jury or the court trying the case without a jury, confinement in jail for not more than 12 months and a fine of not more than \$2,500, either or both [Code of Virginia, Title 18.2 § 18.2-10. (f)].
- Second or subsequent violation, Class 5 felony, 1-10 years, or in the discretion of the jury or the court trying the case without a jury, confinement in jail for not more than 12 months and a fine of not more than \$2,500, either or both [Code of Virginia, Title 18.2 § 18.2-10(e)] [Code of Virginia, § 58.1-1017(B) and (C)].

**Wisconsin:** Any person who makes or signs any false or fraudulent report or who attempts to evade the cigarette or tobacco tax or who aids or abets in the evasion or attempted evasion of that tax may be fined not more than \$10,000 or imprisoned for not more than 9 months or both [Wis. Stat. 139.44 (2)].

## **False or Fraudulent Returns**

This is a criminal penalty that is generally imposed if a person or consumer files a return, report, or other document; or maintains or provides invoices subject to review, and the material matter is known by the person or consumer to be fraudulent or false.

### **Minnesota:**

- Filing a return, report, or other document, or maintaining or providing invoices subject to review, known by the person or consumer to be fraudulent or false concerning a material matter, is a felony (imprisonment for not more than 5 years or payment of a fine of not more than \$10,000, or both [Minn. Stat. 609.03]).
- Knowingly aiding or assisting in, or advises in the preparation or presentation of a return, report, invoice, or other document that is fraudulent or false concerning a material matter, whether or not the falsity or fraud is committed with the knowledge or consent of the person or consumer authorized or required to present the return, report, invoice, or other document, is a felony imprisonment for not more than 5 years or to payment of a fine of not more than \$10,000, or both [Minn. Stat. 609.03] [Minn. Stat. 297F.20 sub 3].

**California:** Any person who fails or refuses to file any report required to be made, or who fails or refuses to furnish a supplemental report or other data, or who fails or refuses to allow an inspection, or who renders a false or fraudulent report is guilty of a misdemeanor and subject to a fine not to exceed \$1,000 for each offense [California Revenue and Taxation Code, Section 30471].

Any person required to make, render, sign, or verify any report who makes any false or fraudulent report with intent to defeat or evade the determination required by law to be made is guilty of a misdemeanor and will for each offense be fined not less than \$300 and not more than \$5,000, or be imprisoned for not exceeding 1 year in the county jail, or be subject to both fine and imprisonment, in the discretion of the court [California Revenue and Taxation Code, Section 30472].

**Illinois:** Cigarette – Class 4 felony. [Illinois 35 ILCS 130/25 (Cigarette Tax)], [Illinois 35 ILCS 135/31 (Cigarette Use)].

OTP – When the tobacco products tax amount due is under \$300, Class 4 felony. When the tobacco products tax amount due is over \$300, Class 3 felony. [Illinois 35 ILCS 143/10-29 (Tobacco)], [Illinois 35 ILCS 143/10-50 (Tobacco)].

**Iowa:** No specific criminal penalty for fraud.

**Michigan:** No specific criminal penalty found.

**New Jersey:** No specific criminal penalty found.

**New York:** The definition of fraud in New York covers a broader definition than most states and also includes failure to file a return or report and failure to remit tax collected [New York Tax Law §1801].

Criminal tax fraud in the fifth degree – commits tax fraud, Class A misdemeanor of up to 1 year and up to \$1,000 fine [New York Tax Law §1802].

Criminal tax fraud in the fourth degree – commits a tax fraud act with the intent to evade any tax due in a period of 1 year in excess of \$3,000 less than the tax liability that is due, Class E felony of 1-4 years imprisonment, fine of \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense [New York Pen. §70.00(e) and § 80.00 and §80.10] [New York Tax Law § 1803].

Criminal tax fraud in the third degree – commits a tax fraud act with the intent to evade any tax due in a period of 1 year in excess of \$10,000 less the tax liability that is due, Class D felony of 1-7 years imprisonment, fine \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense [New York Pen. §70.00(d) and § 80.00 and §80.10] [New York Tax Law § 1804].

Criminal tax fraud in the second degree – commits a tax fraud act with the intent to evade any tax due in a period of 1 year in excess of \$50,000 less than the tax liability that is due, Class C felony of 1-15 years imprisonment, fine of \$15,000. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense [New York Pen. §70.00(c) and § 80.00(iii) and §80.10] [New York Tax Law § 1805].

Criminal tax fraud in the first degree – commits a tax fraud act with the intent to evade any tax due in a period of 1 year in excess of \$1,000,000, Class B felony of 1-25 years, fine \$30,000. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense (New York Pen. §70.00(b) and § 80.00(iii) and §80.10) [New York Tax Law § 1806].

Aggregation – For purposes of this article, the payments due and not paid under article one of this chapter pursuant to a common scheme or plan or is due and not paid, within 1 year, may be charged in a single count, and the amount of underpaid tax liability incurred, within 1 year, may be aggregated in a single count [New York Tax Law § 1807].

**North Dakota:** No specific criminal penalty found.

**Ohio:** First conviction – Misdemeanor of the first degree [O.R.C. 5743.99(A) (1)], up to 180 days imprisonment [O.R.C. 2929.24(1)] and maximum fine or \$1,000 [O.R.C. 2929.28(A) (2) (a) (i)].  
Second conviction – Felony of fourth degree [O.R.C 5743.99(A) (1)], 6-18 months imprisonment [O.R.C. 2929.14(A) (b) (4)] and maximum fine or \$5,000 [O.R.C. 2929.18(A) (3) (a)].

**South Dakota:** No specific criminal penalty found.

**Virginia:** Class 6 felony of 1-5 years imprisonment or in the discretion of the jury or court trying the case without jury, up to 12 months, \$2,500, or both [Code of Virginia, Title 18.2 § 18.2-10(f)]. Each record kept and each report or return filed containing one or more false statements shall constitute a separate offense [Code of Virginia, § 58.1-1008.2].

**Wisconsin:** Fined not more than \$10,000 or imprisoned for not more than 9 months or both [Wis. Stat. 139.44 93) (cigarette)] [Wis. Stat. 139.85 (1) (tobacco)]

## Failure to Keep Records

This is a criminal penalty that is generally imposed when a business fails to keep proper books, records, or invoices.

- Minnesota:** No specific criminal penalty found.
- California:** Misdemeanor – Each offense is a maximum \$5,000 fine, imprisonment up to 1 year in a county jail, or both [California Business and Professions Code, Section 22978.4, Section 22978.5, Sections 22979.4, 22979.5, and 22979.6,].
- Illinois:** Cigarette – A Class 4 felony [Illinois 35 ILCS 130/14] and may be fined up to \$5,000 [Illinois 35 ILCS 130/15].
- Cigarette Use – A Class A 35 ILCS misdemeanor [Illinois 135/22] and may be fined up to \$1,000 [Illinois 35 ILCS 135/23].
- Tobacco Products Tax – A Class 4 felony. A person commits a separate offense for each day engaged in business [Illinois 35 ILCS 143/10-50].
- Iowa:** Other tobacco tax – licensee refusing examination of records, serious misdemeanor, up to 1 year in jail and a fine of between \$315 and \$1,875 [Iowa Code Title XVI, Subtitle 3, Chapter § 903.1.] [Iowa Code, §453A.45].
- Michigan:** No specific criminal penalty found.
- New Jersey:** No specific criminal penalty found.
- New York:** No specific criminal penalty found.
- North Dakota:** No specific criminal penalty found.
- Ohio:** No specific criminal penalty found.
- South Dakota:** No specific criminal penalty found.
- Virginia:** Class 2 misdemeanor, up to 6 months in jail, up to \$1,000 fine, or both [Code of Virginia, Title 18.2 § 18.2-11(b)], [Code of Virginia, § 58.1-1007], [Code of Virginia, § 58.1-1021].
- Wisconsin:** Fined not less than \$100 or more than \$500 or imprisoned not more than 6 months or both [Wis. Stat. 139.44(3) (Cigarette), 139.85 (1) (Tobacco)].

## Counterfeit Stamps

This is a criminal penalty that is generally imposed if a person makes, alters, forges, or counterfeits a stamp, or is in possession of an altered, forged, or counterfeit stamp.

**Minnesota:** A felony – (imprisonment for not more than 5 years or payment of a fine of not more than \$10,000, or both [Minn. Stat. 609.03 and 297F.20 sub 4]).

**California:** Making counterfeit stamps – felony, imprisonment 2, 3, or 4 years, or a fine of \$1,000 - \$25,000, or both [California Revenue and Taxation Code, Section 30473].

Possessing, selling, or offering to sell, or buys or offers to buy, any false or fraudulent stamps or meter impressions – misdemeanor, penalty of \$5,000, or imprisonment not exceeding 1 year in a county jail, or both the fine and imprisonment for less than 2,000 stamps. Penalty of \$50,000 or imprisonment not exceeding 1 year in a county jail, or by both for more than 2,000 stamps [California Revenue and Taxation Code, Section 30473.5].

**Illinois:** Class 2 felony. [Illinois 35 ILCS 130/22 (Cigarette Tax)]  
Class 3 felony. [Illinois 35 ILCS 135/28 (Cigarette Use Tax)]

**Iowa:** Aggravated misdemeanor – up to 2 years imprisonment, \$625 - \$6,250 [Iowa Code Title XVI, Subtitle 3, Chapter 903, § 903.1.] [Iowa Code, §453A.38].

**Michigan:** A felony and imprisonment for not less than 1 year or more than 10 years and may be punished by a fine of not more than \$50,000. [MCL 205.428 (6)].

**New Jersey:** Third degree crime [N.J. Rev. Stat. 54:40A-29].

**New York:** Class E felony, 1-4 years imprisonment, fine \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense [New York Pen. §70.00(e) and § 80.00 and §80.10] [New York Code, Article 37 § 1814. (g)].

**North Dakota:** No specific criminal penalty found.

**Ohio:** First conviction – felony of the fourth degree [O.R.C. 5743.99(B)], 6-18 months imprisonment [O.R.C. 2929.14(A) (b) (4)] and maximum fine of \$5,000 [O.R.C. 2929.18(A) (3) (a)].

Second conviction – felony of the second degree [O.R.C. 5743.99(B) 2-8 years [O.R.C. 2929.14(A) (2)], and maximum fine of \$15,000 [O.R.C. 2929.18(A) (2) (c)].

**South Dakota:** Class 4 felony [SDCL 10-50-21].

**Virginia:** Class 6 felony, 1-5 years imprisonment, or in the discretion of the jury or court trying the case without a jury, up to 12 months, fine up to \$2,500, or both. [Code of Virginia, Title 18.2 § 18.2-10(f)]. [Code of Virginia, § 58.1-1009].

**Wisconsin:** Class G felony [Wis. Stat. 139.44 (1m) (Cigarette)].

### **Counterfeit Cigarettes/Papers or Gray Market Cigarettes/Papers**

This is a criminal penalty that is generally imposed if a person possesses, acquires, transports, or offers for sale counterfeit cigarettes, counterfeit cigarette papers, gray market cigarettes, or gray market cigarette papers.

**Minnesota:** No specific criminal penalty found.

**California:** A misdemeanor and product seizure. Less than 2 cartons of cigarettes, license revocation and \$5,000 fine, or up to 1 year in county jail, or both; 2 or more cartons of cigarettes, license revocation and up to \$50,000 fine or up to 1 year in county jail, or both [California Revenue and Taxation Code, Section 30474.1].

**Illinois:** Class 2 felony [Illinois 35 ILCS 130/23].

**Iowa:** No specific criminal penalty found for counterfeit cigarettes.

**Michigan:** A misdemeanor and a fine of not more than \$1,000 or imprisonment of not more than 90 days or both for

- 600 or more, but not more than 1,199 cigarettes,
- tobacco products with an aggregate wholesale value of \$50 or more but less than \$100, or
- 60 or more, but not more than 1,199, counterfeit cigarettes, counterfeit cigarette papers, gray market cigarettes, or gray market cigarette papers [MCL 205.428 (11)].

**New Jersey:** Third degree crime [N.J. Rev. Stat. 54:40A-29.1].

**New York:** No Specific penalty found.

**North Dakota:** No specific criminal penalty found.



**Ohio:** First conviction – Misdemeanor of the first degree [O.R.C. 5743.99(D)], up to 180 days imprisonment [O.R.C. 2929.24(1)] and maximum fine or \$1,000 [O.R.C. 2929.28(A) (2) (a) (i)].

Second conviction – Felony of the fifth degree [O.R.C. 5743.99(D)], 6-12 months imprisonment [O.R.C. 2929.24(A) (3) (b) (v)], and maximum fine of \$2,000 [O.R.C. 2929.18(A) (3) (e)].

**South Dakota:** Class 1 misdemeanor [SDCL 10-50-65.].

**Virginia:** Gray market cigarettes – possesses, acquires, transports, or offering to sell, or failure to report imported cigarettes, shall be guilty of a Class 5 felony [Code of Virginia § 58.1-1036.], 1-10 years imprisonment, or in the discretion of the jury or the court trying the case without a jury, confinement in jail for not more than 12 months and a fine of not more than \$2,500, either or both [Code of Virginia, Title 18.2 § 18.2-10(e)].

**Wisconsin:** No specific criminal penalty found.

## **Unstamped Cigarettes; Untaxed Tobacco Products; Contraband**

This is a criminal penalty that is generally imposed on a person (other than someone authorized) for possessing, receiving, or transporting unstamped cigarettes or untaxed tobacco products deemed to be contraband. However, it can apply to license holders. This penalty is usually tiered in severity depending on the volume the person possesses, receives, or transport. Many statutes will state that an individual in possession of a certain amount is presumed not to be a consumer.

### **Minnesota:**

- Fewer than 5,000 unstamped cigarettes, or up to \$350 worth of untaxed tobacco products is a misdemeanor (imprisonment for not more than 1 year or to payment of a fine of not more than \$3,000, or both [Minn. Stat. 609.03 and 297F.20 sub 6]).
- 5,000 or more, but fewer than 20,001 unstamped cigarettes, or more than \$350 but less than \$1,400 worth of untaxed tobacco products is a gross misdemeanor (imprisonment for not more than 1 year or to payment of a fine of not more than \$3,000, or both [Minn. Stat 609.03 and 297F.20 sub 6]).
- More than 20,000 unstamped cigarettes, or \$1,400 or more worth of untaxed tobacco products is a felony (imprisonment for not more than 5 years or to payment of a fine of not more than \$10,000, or both [Minn. Stat 609.03 and 297F.20 sub 6]).

**California:** Misdemeanor for possessing unstamped/untaxed cigarettes or tobacco –

First violation, seizure >20 packages of unstamped cigarettes – \$1,000 fine or up to 1 year imprisonment in a county jail, or both.

Second violation within five years >20 packages of unstamped cigarettes – license revocation, \$2,000 - \$5,000 fine or up to 1 year imprisonment in a county jail, or both.

First violation, seizure of 20 packages or more of unstamped cigarettes – \$2,000 fine or up to 1 year imprisonment in a county jail, or both.

Second violation within five years of 20 packages or more of unstamped cigarettes or more – license revocation, \$5,000 - \$50,000 fine, or up to 1-year imprisonment in a county jail, or both. [California Business and Professions Code, Section 22974.3 (retailers) and 22978.2 (wholesaler/distributors)].

Untaxed tobacco – Seizure and misdemeanor. Each offense up to \$5,000 fine or imprisonment not exceeding 1 year in a county jail, or both the fine and imprisonment. [California Business and Professions Code, Section 22974.3 (retailers) and 22978.2 (wholesaler/distributors)].

Any person other than a licensed distributor – who knowingly possesses, or keeps, stores, or retains for the purpose of sale, or sells or offers to sell, any package of cigarettes to which there is not affixed the stamp or meter impression required is guilty of a misdemeanor for each offense, fine up to \$25,000, or be imprisoned up to 1 year in county jail, or, both fine and imprisonment in the county jail. Also, \$100 for each carton of 200 cigarettes, or portion thereof, if that person knowingly possessed, or kept, stored, or retained for the purpose of sale, or sold or offered for sale [California Revenue and Taxation Code, Section 30474].

Placing cigarettes in vending machine without indicia – misdemeanor, up to \$1,000 fine or up to 1 year in county jail, or both [California Revenue and Taxation Code Section 30476].

**Illinois:**

- a) For Cigarette – 100 or less unstamped packages of cigarettes is a Class A misdemeanor. [Illinois 35 ILCS 130/24 (Cigarette)]  
For Cigarette Use tax – More than 9 but less than 101 unstamped packages of cigarettes is a Class A misdemeanor [Illinois 35 ILCS 135/30 (Cigarette Use Tax)].
- b) More than 100 but less than 251 is a Class A misdemeanor for the first offense and a Class 4 felony for each subsequent offense [Illinois 35 ILCS 130/24 (Cigarette Tax) [Illinois 35 ILCS 135/30 (Cigarette Use Tax)].
- c) More than 250 but less than 1,001 is a Class 4 felony [Illinois 35 ILCS 130/24 (Cigarette Tax)] [Illinois 35 ILCS 135/30 (Cigarette Use Tax)].
- d) More than 1,000 is a Class 3 felony [Illinois 35 ILCS 130/24 (Cigarette Tax)] [Illinois 35 ILCS 135/30 (Cigarette Use Tax)].
- e) A licensed distributor, secondary distributor, or transporter, who possess or sells 100 or less original packages of contraband cigarettes is guilty of a Class A misdemeanor [Illinois 35 ILCS 130/24 ], [Illinois 35 ILCS 135/30 (Cigarette Use Tax)].
- f) A licensed distributor, secondary distributor, or transporter, who possesses or sells more than 100 original packages of contraband cigarettes, is guilty of a Class 4 felony [Illinois 35 ILCS 130/24 (Cigarette Tax)] [35 ILCS 135/30 (Cigarette Use Tax)].

**Iowa:**

No criminal penalty.

**Michigan:**

- A felony and a fine of not more than \$5,000 or imprisonment for not more than 5 years, or both when a manufacture representative sells, exchanges, or disposes of cigarettes or tobacco products that do not bear the stamp or other marking required by the department. [MCL 205.428 (2)].
- A felony and a fine of not more than \$50,000 or imprisonment for not more than 5 years, or both for 3,000 or more cigarettes, tobacco products with an aggregate wholesale price of \$250 or more.
- 3,000 or more counterfeit cigarettes, 3,000 or more counterfeit cigarette papers, 3,000 or more gray market cigarettes, or 3,000 or more gray market cigarette papers [MCL 205.428 (3)].
- A misdemeanor and a fine of not more than \$5,000 or imprisonment of not more than 1 year, or both for 1,200 or more, but not more than 2,999, cigarettes, tobacco products with an aggregate wholesale value of \$100

or more but less than \$250, or 1,200 or more, but not more than 2,999, counterfeit cigarettes, counterfeit cigarette papers, gray market cigarettes, or gray market cigarette [MCL 205.428 (4)].

**New Jersey:** Crime of the third degree for selling cigarettes without stamps being affixed [N.J. Rev. Stat. 54:40A-25].

Crime of the fourth degree for possessing 2,000 or more but fewer than 20,000 cigarettes without stamps [N.J. Rev. Stat. 54:40A-28.1].

Crime of the third degree for 20,000 or more cigarettes without the stamp [N.J. Rev. Stat. 54:40A-28.1].

Every transporter who fails to possess proper invoices or delivery tickets for cigarettes is guilty of a crime of the fourth degree, and may liable to a penalty equal to double the amount of tax due on any unstamped cigarettes transported [N.J. Rev. Stat. 54:40A-32].

**New York:**

- First offense – a misdemeanor, if unclassified, jail time amount fixed by the court in accordance with the provisions of the law or ordinance that defines the crime, fine is amount fixed by the court in accordance with the provisions of the law or ordinance that defines the crime; if Class A, up to 1 year, and up to \$1,000 fine; if person gains money or property, fine \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher [New York Pen. §70.15. § 80.05].
- Subsequent within 5 years – Class E felony 1-4 years imprisonment, fine \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense [New York Pen. §70.00(e) and § 80.00 and §80.10].
- 10,000 or more cigarettes – Class E felony 1-4 years imprisonment, fine \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense [New York Pen. §70.00(e) and § 80.00 and §80.10].
- 30,000 or more cigarettes - Class D felony, up to 7 years, fine \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense (New York Pen. §70.00(d), § 80.00 and §80.10) [New York Code, Article 37 §1814].

Any dealer, other than a distributor appointed by the commissioner, who shall knowingly transport or have in his custody, possession or under his control

more than 10 pounds of tobacco or more than 500 hundred cigars upon which the taxes have not been assumed or paid by a distributor appointed by the commissioner, or other person treated as a distributor, shall be guilty of a misdemeanor punishable by a fine of not more than \$5,000 dollars or by a term of imprisonment not to exceed 30 days [New York Code, Article 37 §1814. (h) (1)].

Any person, other than a dealer or a distributor appointed by the commissioner, who shall knowingly transport or have in his custody, possession or under his control more than 15 pounds of tobacco or more than 750 cigars upon which the taxes imposed have not been assumed or paid by a distributor appointed by the commissioner, or other person treated as a distributor, shall be guilty of a misdemeanor punishable by a fine of not more than \$5,000 or by a term of imprisonment not to exceed 30 days [New York Code, Article 37 §1814. (h) (2)].

Any person, other than a distributor appointed by the commissioner, who shall knowingly transport or have in his custody, possession or under his control 2,500 or more cigars or 50 or more pounds of tobacco upon which the taxes have not been assumed or paid by a distributor appointed by the commissioner, or other person treated as a distributor, shall be guilty of a misdemeanor. Provided further, that any person who has twice been convicted under this subdivision shall be guilty of a class E felony for any subsequent violation of this section, regardless of the amount of tobacco products involved in such violation. Class E felony 1-4 years imprisonment, fine \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense [New York Code, Article 37 §1814. (h) (3)] [New York Pen. §70.00(e) and § 80.00 and §80.10].

**North Dakota:** N/A

**Ohio:** *Possessing unstamped, selling without a stamp -Less than 1,200 cigarettes*

First conviction – Minor misdemeanor [O.R.C. 5743.99(A) (2)]

Second conviction - Misdemeanor of the first degree [O.R.C. 5743.99(A) (1)], up to 180 days imprisonment [O.R.C. 2929.24(1)] and maximum fine of \$1,000 [O.R.C. 2929.28(A) (2) (a) (i)]

Possessing unstamped, selling without a stamp -1,200 or more cigarettes

First conviction - Misdemeanor of the first degree [O.R.C. 5743.99(A) (1)], up to 180 days imprisonment [O.R.C. 2929.24(1)] and maximum fine or \$1,000 [O.R.C. 2929.28(A) (2) (a) (i)].

Second conviction - Felony of fourth degree [O.R.C. 5743.99(A) (1)], 6-18 months imprisonment [O.R.C. 2929.14(A) (b) (4)] and maximum fine or \$20,000 [O.R.C. 2929.18(A) (3) (a)]

**South Dakota:** First offense is a Class 2 misdemeanor. Any subsequent violation is a Class 6 felony [SDCL 10-50-32].

**Virginia:** (Selling unstamped): Wholesale dealers; penalty - Class 2 misdemeanor, up to 6 months jail time, up to \$1,000 fine, or both [Code of Virginia, Title 18.2 § 18.2-11(b)] [Code of Virginia, § 58.1-1010].

**Wisconsin:**

- If the number of cigarettes does not exceed 6,000, a fine of not more than \$200 or imprisonment for not more than 6 months or both. [Wis. Stat. 139.44(8) (a)].
- If the number of cigarettes exceeds 6,000 but does not exceed 36,000, a fine of not more than \$1,000 or imprisonment for not more than 1 year in the county jail or both. [Wis. Stat. 139.44(8) (b)].
- (c) If the number of cigarettes exceeds 36,000, the person is guilty of a Class I felony [Wis. Stat. 139.44 (8) (c)].

## **Operating Without a License/ Sales After License Revocation**

This is a criminal penalty that is generally imposed when a person is operating without a license or permit or a person sells cigarettes or tobacco products after the person's license has been revoked or suspended.

**Minnesota:** A person selling cigarettes or tobacco products after the person's license has been revoked is guilty of a felony (imprisonment for not more than 5 years or to payment of a fine of not more than \$10,000, or both [Minn. Stat. 609.03 and 297F.20 (sub 8)].

**California:** Sales with no license or license is suspended or revoked - misdemeanor, each offense is a maximum \$5,000 fine, imprisonment up to 1 year in a county jail, or both, each day is a separate offense [California Revenue and Taxation

Code, Section 30149 (Unlicensed distribution, any person), Section 30158, Section 30159 (Wholesalers), and Business and Professions Code, Section 22980.2, imposes California Business and Professions Code, Section 22981].

Continued sales or gifting of cigarettes and tobacco products either without a valid license or after a notification of suspension or revocation - misdemeanor, each offense is a maximum \$5,000 fine, imprisonment up to 1 year in a county jail, or both, includes seizure [California Business and Professions Code, Section 22980.2, imposes Section 22981 penalties by reference on corporate officers as well)].

Suspension or revocation posting requirement - a civil penalty \$1,000 for each offense [California Business and Professions Code, Section 22980.5 (e) (Retailer) notwithstanding Section 22981 (criminal penalties)].

*Transporting* - Transporting [California Revenue and Taxation Code, Section 30431-30432] without a permit, or no invoices, bills of lading, or delivery tickets: misdemeanor. Fine up to \$1,000 or up to 1 year in the county jail, or both. Transporting with intent to defeat or evade tax, transports 40,000 or more cigarettes or tobacco products with a value of \$5,000 or more and no permit, up to 1 year imprisonment in the county jail [California Revenue and Taxation Code, Section 30475].

**Illinois:** Acting as a cigarette distributor or secondary distributor Class 4 felony. [Illinois 35 ILCS 130/26 (Cigarette Tax)].

Acting as the agent or representative of a distributor who does not maintain a place of business in the State is a Class A misdemeanor. Each and every day any such person so acts is a separate offense [Illinois 35 ILCS 135/34 (Cigarette Use Tax)].

Licensing violation is a Class 4 felony. A person commits a separate offense for each day engaged in business [Illinois 35 ILCS 143/10-50 (OTP Tax)].

**Iowa:** Knowingly operates without a distributor/sub-jobber license — serious misdemeanor, up to 1 year in jail and a fine of between \$315 and \$1,875 [Iowa Code Title XVI, Subtitle 3, Chapter § 903.1.] [Iowa Code, §453A.50 (1)]

**Michigan:** Misdemeanor punishable by a fine of not more than \$1,000 or imprisonment for not more than 1 year, or both [MCL 205.53 (3)].

**New Jersey:** Disorderly person offense<sup>124</sup>

**New York:** OTP - misdemeanor punishable by a fine of not more than \$5,000 or by a term of imprisonment not to exceed 30 days when the unlicensed distributor imports 50 cigars or more than one pound of tobacco, or produces, manufactures or compounds tobacco products. If, within any 90-day period, 1,000 or more cigars or 500 pounds or more of tobacco are imported or caused to be imported or are produced, manufactured or compounded by any person while not appointed as a distributor of tobacco products, is guilty of a misdemeanor. Provided further, that any person who has twice been convicted is guilty of a class E felony with 1-4 years imprisonment, fine \$5,000 or double the amount of the defendant's gain from commission of the crime, whichever is higher. If a corporation, the higher of \$10,000 or double the amount of the corporation's gain from commission of the offense. [New York Pen. §70.00(e) and § 80.00 and §80.10] for any subsequent violation of this section, regardless of the amount of tobacco products involved in such violation [New York Code, Article 37 § 1814-a.].

**North Dakota:** No specific criminal penalty found.

**Ohio:** No specific criminal penalty found.

**South Dakota:** Any person, except a retailer, who sells, offers for sale, or possesses with intent to sell, any cigarettes or tobacco products, without a license or registration commits a petty offense. [SDCL 10-50-9.] . Any person who sells any cigarettes or tobacco products after such person's license or registration has been revoked commits a petty offense, and all cigarettes or tobacco products in such person's possession shall be seized and forfeited to the state pursuant to chapter 23A-37 [SDCL 10-50-16].

**Virginia:** Any person other than an authorized holder who possesses, with intent to distribute, more than

- >5,000 (25 cartons) - <100,000 (500 cartons) tax-paid cigarettes - Class 1 misdemeanor up to 12 months in jail, fine up to \$2,500 or both (Code of Virginia, Title 18.2 § 18.2-11(b)), first offense; second or subsequent offense: Class 6 felony, 1-5 years imprisonment, or in the discretion of the jury or court trying the case without a jury, up to 12 months, fine up to \$2,500, or both. [Code of Virginia, Title 18.2 § 18.2-10(f)].
- 100,000 (500 cartons) or more - Class 6 felony for a first offense Class 6 felony, 1-5 years imprisonment, or in the discretion of the jury or court trying the case without a jury, up to 12 months, fine up to \$2,500, or both. [Code of Virginia, Title 18.2 § 18.2-10(f)]; second or subsequent offense: Class 5 felony, 1-10 years imprisonment, or in the discretion of the jury or the court trying the case without a jury, confinement in jail for not more than 12 months and a fine of not more than \$2,500, either or both [Code of Virginia, Title 18.2 § 18.2-10(e)].



- Civil penalty
  - (i) \$2.50 per pack, but no more than \$5,000, for a first offense;
  - (ii) \$5 per pack, but no more than \$10,000, for a second such offense committed within a 36-month period; and
  - (iii) \$10 per pack, but no more than \$50,000, for a third or subsequent such offense committed within a 36-month period. [Code of Virginia, § 58.1-1017.1].

**Wisconsin:** Operating without a license or sale after license has been revoked. Any person operating without a license or making sales after a license is revoked is subject to a fine. If upon such second or subsequent violation, the person was personally guilty of a failure to exercise due care to prevent the violation, the person is fined not more than \$300 nor less than \$25 or imprisoned not exceeding 60 days or both [Wis. Stat. 134.65 (5)].

## Refusal to Permit Authorized Examination or Inspection

This is a criminal penalty that is generally imposed if a business refuses to allow an authorized person to examine or inspect the premises.

**Minnesota:** No specific criminal penalty found.

**California:** Misdemeanor, fine up to \$1,000 for each offense. [California Revenue and Taxation Code, Sections 30471 and 30435] [Business and Professional Code, Section 22980 and 22981].

**Illinois:** No specific criminal penalty found.

**Iowa:** Serious misdemeanor, up to one year in jail and a fine of between \$315 and \$1,875. [Iowa Code Title XVI, Subtitle 3, Chapter § 903.1.] [Iowa Code, §453A.45].

**Michigan:** No specific criminal penalty found.

**New Jersey:** No specific criminal penalty found.

**New York:** No specific criminal penalty found.

**North Dakota:** No specific criminal penalty found.

**Ohio:** First conviction - felony of the fourth degree [O.R.C. 5743.99(B)], 6-18 months imprisonment [O.R.C. 2929.14(A) (b) (4)] and maximum fine of \$5,000 [O.R.C. 2929.18(A) (3) (a)].

Second conviction - felony of the second degree [O.R.C. 5743.99(B)] 2-8 years [O.R.C. 2929.14(A) (2)], and maximum fine of \$15,000 [O.R.C. 2929.18(A) (2) (c)].

**South Dakota:** No specific criminal penalty found.

**Virginia:** Any person who fails or refuses to keep and preserve the records as required shall be guilty of a Class 2 misdemeanor, up to 6 months in jail, up to \$1,000 fine, or both [Code of Virginia, Title 18.2 § 18.2-11(b)] [Code of Virginia, § 58.1-1007].

Any person who upon request by an agent of the Department fails or refuses to allow an audit or inspection of records as provided, shall have his stamping permit suspended until such time as the Department is allowed to audit or inspect the records. The Department may impose a penalty of \$1,000 for each day that the person fails or refuses to allow an audit or inspection of the records. This is a Class 2 misdemeanor, up to 6 months in jail, up to \$1,000 fine, or both [Code of Virginia, Title 18.2 § 18.2-11(b)] [Code of Virginia, § 58.1-1008.1].

**Wisconsin:** Fined not more than \$500 or imprisoned not more than 90 days or both. Such refusal shall be cause for immediate suspension or revocation of permit by the secretary [Wis. Stat. 139.44 (4)] [Wis. Stat. 139.85 (1) (Tobacco)].

## Interest

Interest is generally charged on unpaid tax however, some states do not pay interest on overpayment.

- Minnesota:** Interest is charges on the unpaid tax plus penalty from the date the tax was due until it is paid in full. Current interest rate as of 11/20/2013 is 3 percent. The rate of interest is determined by the commissioner each year and is equal to the prime rate charged by banks during the six-month period ending on September 30 of that year, rounded to the nearest full percent. The rate of interest becomes effective on January 1 of the immediately succeeding year except as otherwise provided. The term "prime rate charged by banks" means the average predominant prime rate quoted by commercial banks to large businesses, as determined by the Board of Governors of the Federal Reserve System [Minn. Stat. 297F.18 and 270C.40 (5)].
- California:** Unpaid tax; Interest at the modified adjusted rate per month, or fraction thereof, established pursuant to Section 6621 of the Internal Revenue Code (underpayment rate) plus 3 percentage points, simple interest [California Revenue and Taxation Code, Sections 6591.5 (c), 30171, 30202, 30223, 30281, and 30281.5]. Overpayment of tax; Interest is paid "at the modified adjusted rate per annum" [Established by California Revenue and Taxation Code, Section 6591.5 (2) (d) (1).]
- Illinois:** Interest is charged and paid at the annual rate. The underpayment rate established under Section 6621 of the Internal Revenue Code is used. The interest rate is adjusted on a semiannual basis, on January 1 and July 1. [Illinois Uniform Penalty and Interest Act [35 ILCS 735/3-2]].
- Iowa:** The rate of interest in effect during a calendar year is the rate which is 2 percentage points greater than the numerical average, rounded to the nearest 1 percent, of the respective prime rates for each of the months in the twelve-month period that ends September 30 of the previous calendar year. The rate of interest established takes effect January 1, and applies to any amount which is due or becomes payable on or after that date. In the event interest accrues or is calculated on a monthly basis, the rate of interest for each month shall be one-twelfth, rounded to the nearest one-tenth of one percent [Iowa Code, §421.7 (2) and (4)].
- Michigan:** For the period beginning on July 1, 2013, and ending on December 31, 2013. A daily rate of interest (.0001164) based on an adjusted annual rate of 4.25 percent will be added to a tax deficiency or an excessive claim for the period stated above. The effective annual rate, 4.25 percent, is 1 percentage point

above the “adjusted prime rate” charged by three commercial banks to large businesses<sup>125</sup> [MCL 205.23 Section 23 (2)].

- New Jersey:** Current rate is 6.25 percent. The rate is calculated as follows: Prime Rate (3.25 percent) + 3 percent = 6.25 percent, compounded annually. Under the Taxpayers’ Bill of Rights, interest assessed on outstanding tax balances is Prime Rate plus 3 percent. Prime rate for this purpose is the average predominant prime rate, as determined by the Board of Governors of the Federal Reserve System that was in effect on December 1 of the year prior to the year in which the tax became due. At any time that the Director determines that the prime rate varies by more than 1 percentage point from the rate previously determined, the director shall re-determine the prime rate to be that quoted prime rate for subsequent calendar quarters of the year in which the payments become due.<sup>126</sup>
- New York:** Interest is compounded daily and is set by the commissioner of taxation and finance pursuant. Current rate for the period of 01/01/14 through 03/31/14 is 7.5 percent on underpayments [New York Code Article 20 §481].
- North Dakota:** If there is an underpayment the taxpayer will receive a debit memo and has 30 days to pay with no interest. If an accounts receivable is set up, the interest is 1 percent per month. There is no interest on overpayment because a credit can be used on the next monthly return.<sup>127</sup>
- Ohio:** For most taxes, the interest rate is calculated by adding 3 percentage points to the federal short-term rate (rounded to the nearest percentage point) that was in effect during July of the current year. Based on this formula, the Tax Commissioner has certified that the interest rate that will apply to most overdue taxes for the 2014 calendar year will be 3 percent.<sup>128</sup>
- South Dakota:** 1.25 percent or \$5 whichever is greater for the first month, and 1.25 percent per month thereafter [SDCL 10-59-6].
- Virginia:** Unless otherwise specifically provided, interest on omitted taxes, assessments and refunds under is computed at the rates equal to the rates of interest established pursuant to § 6621 of the Internal Revenue Code. The rate of interest on omitted taxes and assessments is the "Underpayment Rate" established pursuant to § 6621(a) (2) of the Internal Revenue Code plus two percent. The rate of interest on refunds is the "Overpayment Rate" for non-corporate taxpayers established pursuant to § 6621(a) (1) of the Internal Revenue Code plus 2 percent. Separate computations are made by multiplying the deficiency or overpayment for each period by the rate of interest applicable to that period [Code of Virginia, § 58.1-15].

**Wisconsin:** Delinquent interest - 1.5 percent per month [Wis. Stat. 139.44(11) (Cigarette)  
Wis. Stat. 139.85(1) (Tobacco)].  
Unpaid taxes – 12 percent interest per year [Wis. Stat. 139.44(9) (Cigarette)  
Wis. Stat. 139.85(1) (Tobacco)].  
Refunded taxes - 3 percent interest per year [Wis. Stat. 139.44(9) (Cigarette)]  
Wis. Stat. 139.85(1) (Tobacco)].

## Sanctions

Taxing departments may impose sanctions that are usually related to suspension or revocation of a license/permit, loss of discounts, loss of ability to purchase tax stamps, and bonding.

### License Suspension or Revocation

In general, this sanction is widely used for a variety of violations of the tax acts and when a license is suspended or revoked a hearing is usually involved. When a license is suspended or revoked a business is prohibited from operating for a set period of time. Listed below are some of the reasons for a license suspension or revocation.

#### Minnesota:

##### Refusal to issue or renew

- Owes \$500 or more in delinquent taxes
- After demand, has not filed tax returns required;
- Had a cigarette or tobacco license revoked within the past two years;
- Had a sales and use tax permit revoked within the past two years; or
- Has been convicted of a crime involving cigarettes, including but not limited to: selling stolen cigarettes or tobacco products, receiving stolen cigarettes or tobacco products, or involvement in the smuggling of cigarettes or tobacco products. [Minn. Stat. 297F.04 (Subd. 2.)]

##### Cancellation or nonrenewal

- License holder has not filed a cigarette or tobacco products tax return for at least 1 year;
- License holder has not reported any cigarette or tobacco products tax liability on the license holder's returns for at least 1 year; or
- The license holder requests cancellation of the license [Minn. Stat. 297F.04 9 Subd. 2a.).]

##### Failure to comply with reporting requirement related to Sales to Indian Tribes

The permission granted to the wholesaler to keep a stock of unstamped goods is revoked [Minn. Stat. 297F.07].

Failure to allow inspection of premises or records and the packages of cigarettes and vending devices [Minn. Stat. 297F.13 subdivision 1 (e)] [Minn. Stat. 297F.13 subdivision 2 (d)].

### Revocation of Sales and Use Tax Permits

- If a retailer purchases for resale from an unlicensed seller more than 20,000 cigarettes or \$500 or more worth of tobacco products, the person's sales and use tax permit may be revoked. [Minn. Stat. 297F.185 (a)].
- If the retailer, directly or indirectly, purchases for resale cigarettes without the proper stamp affixed [Minn. Stat. 297F.185 (b)].

#### **California:**

License is suspended upon cancellation of bond, or if the bond becomes void or unenforceable, or if the distributor fails to pay any amounts due [California Revenue and Taxation Code, Section 30144 (distributor)].

Failure to comply with any provision or any rule or regulation may result in the revocation of a license [California Revenue and Taxation Code, Section 30148 (distributors)].

Conviction of a felony (Revenue and Taxation Code, Section 30473) for counterfeiting or intent to defeat or evade tax (Revenue and Taxation Code, Section 30480); also, had any permit or license revoked under any provision of the California Revenue and Taxation Code [California Business and Professions Code, Section 22974.4 (retailer/person) and Section 22978.6 (distributor/wholesaler)].

Selling or possessing counterfeit cigarette or tobacco products [California Revenue and Taxation Code, Sections 30221, 30224, 30264, 30474, and 30474.1]

Licenses subject to suspension or revocation for violations of California Business and Professions Code or the Revenue and Taxation Code as provided in this section.

- First conviction - written notice, may suspend for 30 days. (In addition to any applicable fines or penalties for a violation)
- Second conviction within 4 years of a previous violation - license revocation (in addition to any applicable fines or penalties for a violation).

Notice of suspension orders the licensee to cease the sale, gifting, or displaying for sale of cigarettes or tobacco products for the period of the suspension. Continued sales or gifting of cigarettes or tobacco products after the effective date of the suspension results in license revocation. License reinstated upon completion of the suspension period, when all outstanding

debts of that retailer or wholesaler that are owed to a wholesaler or distributor for the purchase of cigarettes and tobacco products are paid.

Revocation orders the licensee to cease the sale, gifting, or displaying for sale of cigarettes or tobacco products on and after the effective date of the revocation. After a revocation, a previously licensed applicant may apply for a new license after 6 months. For purposes of this section, a violation includes violations of the Revenue and Taxation Code relating to cigarettes and tobacco products, and violations of this division. Only one violation per discrete action shall be counted toward a suspension or revocation of a license [California Business and Professions Code, Section 22980.3].

**Illinois:** License revocation for failure to authorized examination or inspections [Illinois 35 ILCS 135/15 & 15a].

**Iowa:** Violation of any provision or rule, or substantially delinquent in paying tax, or if the person is a corporation and if any officer having a substantial legal or equitable interest in the ownership of the corporation owes any delinquent tax of the permit-holding corporation, or interest or penalty on the tax [Iowa Code, §453A.22 (1)].

Unstamped product in vending machine:

- For a first violation, automatic 14-day suspension if civil penalty not paid.
- For a second violation within a period of two years, \$1,500 or 30-day suspension (retailer's preference).
- For a third violation within a period of three years, automatic 30-day suspension.
- For a fourth violation within a period of three years, automatic 60-day suspension.
- For a fifth violation within a period of four years, the retailer's permit shall be revoked [Iowa Code, §453A.22 (2)].

Distributor or sub-jobber - license can be suspended for any violation of any cigarette/tobacco products tax law, or any other act applicable to the sale of tobacco products, or any rule or regulation. If revoked, cannot receive a new license for 12 months [Iowa Code, §453A.44].



Other reasons:

- possession for sale, distribution, or use, or for any other purpose, in excess of 40 cigarettes, or to sell, distribute, use, or present as a gift or prize cigarettes upon which a tax is required to be paid, without having affixed to each individual package of cigarettes
- other than a common carrier and a distributor's truck bearing the distributor's name and permit number in plain view on the outside of such truck, transporting unstamped cigarettes; refusing inspection
- using, selling, offering for sale or possessing previously used stamps; attaching previously used stamps; purchasing from someone other than the department
- knowingly using, consuming, or smoking untaxed cigarettes
- soliciting sales of cigarettes without a permit
- selling untaxed cigarettes or tobacco through a vending machine
- unlicensed retail sales, unlicensed distribution and sales to unlicensed retailer or otherwise does not have state permit as a manufacturer distributing agent, wholesaler, or distributor
- holder of a retail permit selling or distributing cigarettes or tobacco products, including but not limited to a single or loose cigarette, that are not contained within a sealed carton, pack, or package as provided by the manufacturer, which carton, pack, or package bears the health warning that is required by federal law
- ship or import, or to offer for sale, sell, distribute, transport, or possess cigarettes or tobacco products previously exported from or manufactured for use outside the U.S.
- ship or import into this state or to offer for sale, sell, distribute, transport, or possess counterfeit cigarettes, knowing such cigarettes are counterfeit or having reasonable cause to believe that such cigarettes are counterfeit. [Iowa Code, §453A.36]

Offer for sale cigarettes or tobacco products, in a quantity of less than a carton, through the use of a self-service display [Iowa Code, §453A.36A].

No access or free access or is hindered or interfered with in making the examination [Iowa Code, §453A.45 (OTP distributor)].

**Michigan:** The department may suspend, revoke, or refuse to issue or renew a license issued for failure to comply with the Act or for any other good cause [MCL 205.425 (1)].

If a person who is a manufacturer, wholesaler, or unclassified acquirer and is convicted of a felony, the department will revoke any license issued under the act to that person [MCL 205.425 (2)].

**New Jersey:** A minimum suspension may be imposed for not less than 10 or more than 20 consecutive business days for first offenders. Subsequent or plural offenders may have their licenses suspended for not less than 30 consecutive business days. Third offenders may have their licenses revoked [N.J. Rev. Stat. 56-7-33].

**New York:** Violating any statute provision any regulation [NY Code, Article 20 § 480(1) (j) (retailer dealer)].

Upon notification that the applicant or retail dealer has been convicted in a criminal proceeding of a violation of subdivision five of section 260.20 of the penal law or as directed by an enforcement officer pursuant to article thirteen-F of the public health law [New York Code, Article 20 § 480-a (d)].

Where the applicant's or retail dealer's place of business is at the same premises as that of a retail dealer whose retail dealer registration has been revoked and where such revocation is still in effect, unless the applicant or retail dealer provides the commissioner with adequate documentation demonstrating that such applicant or retail dealer acquired the premises or business through an arm's length transaction [New York Code, Article 20 § 480-a (e)].

Other reasons for suspension or revocation:

- failure to file or maintain in full force and effect a bond or other security when required or when the amount thereof is increased
- failure to comply with any of the Provisions of Tax on Cigarettes and Tobacco Products or article twenty-A (Cigarette Marketing Standards) or any rule or regulation adopted; any violation of section four hundred seventy-three-b (cigarettes marked for export outside the U.S.; importation and affixation of stamps prohibited)
- knowingly aiding and abetting another person in violating any of the provisions or regulation adopted [New York Code, Article 20 § 480(3)(a)(i)(ii)(iii)]
- Commits fraud or deceit operations as a wholesale dealer or has committed fraud or deceit in procuring license
- Convicted in a court of competent jurisdiction (in-state or another state) of a felony bearing on the licensee's duties and obligations
- Impersonated any person represented to be a wholesale dealer but not in fact licensed
- Knowingly aided and abetted the sale of cigarettes or tobacco products by a person which such licensee or controlling person knows (A) has not been licensed by the commissioner of taxation and finance and (B)

is a wholesale dealer. [New York Code, Article 20 § 480(3)(b)(i)(ii)(iii)(iv)]

Violating Cigarette Marketing Standards (agent or wholesale dealer)

- First violation - up to 30 day or a civil fine up to \$20,000 or both
- Second or subsequent violation committed within 3 years - license revocation unless (i) the penalty imposed for the first violation was a fine only; or (ii) the commissioner determines, on a showing by the agent or wholesale dealer, that the second or subsequent violation is due to reasonable cause or that such agent or wholesale dealer acted in good faith, in which case the commissioner may suspend such license for a period of not more than 60 days or impose a civil fine not to exceed \$50,000 or both such suspension and fine [New York Code, Article 20 §485(A)].

**North Dakota:** Revocation of license when any dealer or distributor fails to comply with any of the provisions, or any of the rules or regulations prescribed by the tax commissioner or the attorney general. No license may be issued for a period of one year thereafter [North Dakota Century Code, 57-36-04].

**Ohio:** The tax commissioner may suspend or revoke any wholesale or retail cigarette license for the violation of, or the failure of the licensee to comply with the Unfair Cigarette Sales Act [O.R.C. 1333.21].

Court of common pleas may enter order to revoke wholesale or retail cigarette license held by any person convicted of a misdemeanor or felony for certain cigarette tax violations [O.R.C. 5743.17].

Tax commissioner may revoke manufacturer, importer, wholesale, or retail cigarette license for specific cigarette tax violations [O.R.C. 5743.18].

**South Dakota:** The secretary may suspend or revoke any wholesale or retail cigarette license for the violation of, or the failure of the licensee to comply with the Unfair Cigarette Sales Act. In addition to the provisions of §§ 37-10-2, 37-10-3, and 37-10-36 to 37-10-38, inclusive, the secretary of revenue is empowered to suspend or revoke the license or any licenses of any person, licensed under the provisions of chapter 10-50 [SDCL 37-10-29, SDCL 37-29-32, SDCL 10-50-15].

If the secretary of revenue finds that a licensee has failed to comply with any of these provisions or any rule promulgated thereunder, the secretary shall, in the case of the first offender, suspend the license or licenses of the licensee for a period of not less than 5 nor more than 20 days, and for subsequent offenses not less than 20 days nor more than 12 months, and, if the secretary

finds the offender has been guilty of willful and persistent violations, he may revoke the person's license or licenses [SDCL 37-10-32].

**Virginia:**

Fails or refuses to comply with stamping provisions [Code of Virginia, § 58.1-1003(E)].

Forms and kinds of containers, methods of breaking packages, and methods of affixing stamps - license suspended for interfering with enforcement of article [Code of Virginia, § 58.1-1006].

Suspended if refused to allow an audit or inspection of records; suspended until department is allowed to audit or inspect the records [Code of Virginia, § 58.1-1007].

Up to 1 year revocation if the stamping agent fails to file more than 1 of the required reports in a timely manner in any calendar year. [Code of Virginia, § 58.1-1008].

Violating stamping law, bond, etc. [Any person who violates any provision of this section. (Includes wholesaler bond, selling stamps, etc.) [Code of Virginia, § 58.1-1009(C)].

Sale of unstamped cigarettes by wholesale dealers - suspended until the tax and penalties have been paid [Code of Virginia, § 58.1-1010].

Manufacturers, wholesale dealers and retail dealers - The department may refuse to issue a stamping permit or may suspend, revoke or refuse to renew a stamping permit issued to any person, partnership, corporation, limited liability company or business trust, if the principals, managers, and other persons engaged in handling and stamping cigarettes at the licensable location of the applicant has been (i) found guilty of any fraud or misrepresentation in any connection, (ii) convicted of robbery, extortion, burglary, larceny, embezzlement, fraudulent conversion, gambling, perjury, bribery, treason, or racketeering, or (iii) convicted of a felony. [Code of Virginia, § 58.1-1011].

Sell or possess reproduction or counterfeit stamps, second offense - wholesale dealer license [Code of Virginia, § 58.1-1015(B)].

OTP Distributor's license - suspend, revoke or refuse to renew a distributor's license issued to any person, partnership, corporation, limited liability company or business trust, if it determines that the principals, managers, and other persons engaged in handling tobacco products at the licensable location of the applicant have been (i) found guilty of any fraud or misrepresentation in

any connection; (ii) convicted of robbery, extortion, burglary, larceny, embezzlement, fraudulent conversion, gambling, perjury, bribery, treason, or racketeering; or (iii) convicted of a felony. Also, any distributor who is found guilty of violating or noncompliance with any of the provisions, or any of the rules adopted and promulgated [Code of Virginia, § 58.1-1021.04:1].

Any violation of § 58.1-1021.04:1 (Distributor's license provisions) 58.1-1021.04:2 (distributor records and access), 58.1-1021.04:3 (Unlawful importation, transportation, or possession of tobacco products), or 58.1-1021.04:4 (Purchase of tobacco products for resale) of this article shall be grounds for revocation of the license [Code of Virginia, §58.1-1021.04:2(E)].

Wholesale dealer for a violation of the act or any rule adopted [Code of Virginia, § 58.1-1035A].

**Wisconsin:** Operating without a license or sale after license has been revoked. - Any person operating without a license or making sales after a license is revoked is subject to a fine. If upon such second or subsequent violation, the person was personally guilty of a failure to exercise due care to prevent the violation, the person is fined not more than \$300 nor less than \$25 or imprisoned not exceeding 60 days or both. The license of the person convicted of being personally guilty of such failure to exercise due care and the person is not entitled to another license for a period of 5 years, nor can the person in that period act as the servant or agent of a person licensed for the performance of the acts authorized by such a license [Wis. Stat. 134.65 (5)].

Any permit of any permit holder who violates most sections of the Act and the Unfair Sales Act may have their permit suspended or revoked [Wis. Stat. 139.39 (3)].

In addition to the penalties imposed for violation of ss. 139.30 to 139.41 or 139.75 to 139.83 or any of the rules of the department, the permit of any person convicted shall be automatically revoked and he or she shall not be granted another permit for a period of 2 years following such revocation.

## **Forfeited/Seized Property**

In general, anyone who possesses or transports contraband products is guilty of a crime and any product or vehicle used to transport the contraband product are subject to seizure and forfeiture.

**Minnesota:** Seizure. Cigarettes, tobacco products, vending machines, vehicles, trailers, boats, snow mobiles, airplanes, or other property that are deemed to be contraband may be seized by the commissioner or authorized agents or by

any sheriff or other police officer, with or without process, and are subject to forfeiture. [Minn. Stat. 297F.21 Subd. 2].

**California:** The following property, upon seizure by the board or any law enforcement agency, is hereby forfeited to the state

- Cigarettes or tobacco products transported upon the highways, roads or streets of this state in violation of Section 30431 (transporter permit) or Section 30432 (invoices)
- Unstamped cigarettes or untaxed tobacco products, offered for sale, possessed, kept, stored, or owned by any person with the intent of the person to sell without paying tax
- Any cigarette or tobacco product vending machine, together with the cigarettes, tobacco products, money or other contents thereof, that has been loaded, in whole or in part, with unstamped cigarettes or untaxed tobacco products
- Cigarettes or tobacco products to which are affixed California cigarette tax stamps or meter impressions, or for which tax is paid pursuant to Sections 30123 (surtax) and 30131.2 (additional surtax), in violation of Section 30165.1 (MSA), regardless of whether the violation is subject to the defense described in paragraph (2) of subdivision (i) of Section 30165.1. [California Revenue and Taxation Code, Sections 30436, 30449, and 30474.1(d)]

Collection of delinquent payments - Whenever any person is delinquent in the payment of the obligations imposed under this part, the board or its authorized representative may seize any property, real or personal, subject to the lien of the tax and thereafter sell the property, or a sufficient part of it, at public auction to pay the tax due together with any interest and penalties imposed for the delinquency and any costs incurred on account of the seizure and sale [California Revenue and Taxation Code, Section 30355].

**Illinois:** Any cigarettes transported on the highways, roads, or streets that are transported without the proper permit, will be seized along with the vehicle that was used [Illinois 35 ILCS 130/9c].

**Iowa:** All untaxed cigarettes found in the possession or custody, or within the control of any person, for the purpose of being sold, distributed, or removed by the person, and all untaxed cigarettes which are removed, stored, transported, deposited, or concealed in any place, and any automobile, truck, boat, conveyance, or other vehicle whatsoever, used in the removal, storage, deposit, concealment, or transportation of cigarettes for the purpose of avoiding the payment of the proper tax, and all equipment or other tangible personal property incident to and used for the purpose of avoiding the

payment of the proper tax, found in the place, building, or vehicle where cigarettes are found, and all counterfeit cigarettes [Iowa Code, §453A.32].

**Michigan:** Contraband tobacco product held, owned, possessed, transported, or in control of a person in violation of the tobacco tax act, and a vending machine, vehicle, and other tangible personal property containing a tobacco product in violation of this act and any related books and records are contraband and may be seized and confiscated by the department. [MCL 205.429 (9) (1)].

**New Jersey:** Transportation of contraband cigarettes (disorderly person offense). Vehicle subject to seizure and forfeiture by the courts.

Untaxed cigarettes, U.S. tax-exempt or duty-free, and counterfeit-manufactured cigarettes.

Cigarette vending machines that are not properly licensed or that contain untaxed cigarettes, or counterfeit-manufactured cigarettes.

Any vehicle, vessel, device, or paraphernalia used in the unlawful transportation of contraband cigarettes or used in the manufacture of counterfeit tax stamps.

Any monies that are the proceeds of the sale of contraband cigarettes.<sup>129</sup>

**New York:** Untaxed cigarettes, unstamped cigarettes, and any vending machine or receptacle in which held for sale; cigarettes stamped in violation of law. May be redeemed by payment of tax, plus 50 percent penalty and interest on tax, plus cost of incurred. \$500 minimum [New York Code, Article 37, §1846(a)].

Any tobacco products in excess of 500 cigars or 10 pounds of tobacco which are being imported for sale in the state where the person importing or causing such tobacco products to be imported has not been appointed as a distributor; roll-your-own in violation of law may also be seized. (Paragraph a-1). Except for roll-your-own, may be redeemed by payment of tax, plus 50 percent penalty and interest on tax, plus cost of incurred \$500 minimum [New York Code, Article 37, §1846-A (a)].

Any vehicle or other means of transportation used to transport or for the deposit or concealment of more than 100 unstamped or unlawfully stamped packages of cigarettes (excludes common carriers) (b) any vehicle or other means of transportation used to import tobacco products in excess of five hundred cigars or ten pounds of tobacco for sale where the person importing or causing such tobacco products to be imported has not been appointed a

distributor (excludes common carriers) ) [New York Code, Article 37, §1847(a)].

**North Dakota:** All cigarettes, cigarette papers, cigars, pipe tobacco, or OTP in the possession of the person who violates any provision, or in the place of business of the person Any cigarette-making machine that is maintained or operated in violation must be confiscated. [North Dakota Century Code, 57-36-33(2)].

**Ohio** Cigarettes on which no tax has been paid [O.R.C. 5743.08].

Vending machines containing unstamped/metered cigarettes [O.R.C. 5743.112].

Packages to which stamps have been affixed that are gray market, illegal, produced by a tobacco manufacture or part of a brand family not listed in the directory; roll-your-own tobacco sold or offered for sale in violation law [O.R.C. 5743.21 (C)].

Untaxed OTP or commissioner believes tax being avoided (tax evasion) [O.R.C. 5743.55].

License suspension if distributor fails to file or pay tax for two consecutive periods or three periods during any 12-month period [O.R.C. 5743.61].

**South Dakota:** The secretary of revenue and inspectors of the Department of Revenue are charged with the duty of enforcing the provisions of the Act, and are given the power of peace officers and authorized and empowered to arrest any violator of the provisions of the Act, to enter complaint before any court of competent jurisdiction and to seize without formal warrant and use as evidence any forged, counterfeited, spurious, or altered license or stamp found in possession of any person in violation of the Act [SDCL 10-50-34].

Unstamped cigarettes declared to be contraband goods may be seized by the secretary, the secretary's agents, or employees, or by any law enforcement of this state if directed by the secretary to do so, without a warrant [SDCL 10-50-35].

Any cigarettes seized under the provisions of this Act shall be confiscated and forfeited to the state, and the secretary shall sell such property to a licensed dealer or distributor to the best advantage to the state. The proceeds from the sale will be remitted to the secretary of revenue as part of the income for the enforcement of this Act. Such sale by the state will not relieve the purchaser from paying the tax and stamping the articles so sold to him [SDCL 10-50-36].



**Virginia:**           Reproduction or counterfeit stamps, including all fixtures, equipment, materials and personal property used in substantial connection [Code of Virginia, § 58.1-1015(B)].

Unlawful importation, transportation, or possession of tobacco products - including all fixtures, equipment, materials and personal property used in substantial connection with the sale or possession of tobacco products involved in a knowing and intentional violation [Code of Virginia, § 58.1-1021.04:3].

Cigarettes that are acquired, held, owned, possessed, transported in, imported into, or sold or distributed in the Commonwealth in violation of this chapter shall be deemed contraband and shall be subject to seizure, forfeiture, destruction, or court-ordered assignment for use by a law-enforcement undercover operation. Such cigarettes shall be deemed contraband whether or not the violation of this chapter is with knowledge [Code of Virginia, § 58.1-1037].

**Wisconsin:**       All cigarettes acquired, owned, imported, possessed, kept, stored, made, sold, distributed or transported in violation of this chapter, and all personal property used in connection therewith is unlawful property and subject to seizure by the secretary or any peace officer. All cigarettes seized for violating s. 139.31 (4) (Gray Market) or (5) (Alteration of Labels and Warnings) shall be destroyed. [Wis. Stat. 139.40 (1)].

If personal property other than cigarettes is seized the secretary will advertise the same for sale by publication of a notice. If no claimant, either of lien or ownership, notifies the secretary within 10 days after last insertion of such notice, the property will be sold. If such sale is not practical the property may be destroyed. If a claimant of a lien or ownership notifies the secretary within the prescribed time, the secretary may apply to a court of record in the county where the property was seized for an order directing disposition of said property or the proceeds thereof. If a sale of such seized property is ordered, all liens, if any, may be transferred from the property to the proceeds of such sale. Neither the property seized nor the proceeds from the sale will be turned over to any claimant of lien or ownership unless such claimant first establishes that the property was not used in connection with any violation of the Cigarette Tax Act (139.30 to 139.44) or that, if so used, it was done without the claimant's knowledge or consent and without the claimant's knowledge of such facts as should have given the claimant reason to believe it would be put to such use. If no claim of lien or ownership is so established the property may be ordered destroyed. In case of sale, the net proceeds after deducting costs, expenses and established claims shall be paid into the state treasury [Wis. Stat. 139.40 (4)].

# Unique Penalties, Criminal Charges & Sanctions

The penalties listed below are both civil and criminal penalties that appear to be unique to only one or two a particular states that JD Michael surveyed.

## Civil Penalties

### Failure to Display License

This penalty is generally imposed for failure to display a license or permit.

**California:** \$500 penalty for failure to display a license, in addition to any other penalty [California Business and Professions Code, Section 22974.5 (retailer)].

In addition, the Board may impose penalties or sanctions for a variety of offenses or non-compliance with license law provisions from making false statements on an application; failure to maintain 1 year of invoices on the premises, *etc.* For a first offense - sanctions range from the issuance of a warning letter to potential revocation or suspension of the license, second or any subsequent offense, potential license suspension or revocation, or potential civil penalty not to exceed the greater of five times the retail value of the seized cigarettes or tobacco products; or \$5,000 [California Business and Professions Code, Section 22974.7 (Retailers); Section 22978.7(wholesaler or distributor); Section 22979.7 (manufacturer or importer)].

### Penalty for Operating Without a Vending Machine License

This penalty is generally imposed for failure to display a vending machine license or decal.

**New Jersey:** Any cigarette vending machine not bearing a proper license or identification, or that contains unstamped packages of cigarettes, or cigarettes bearing counterfeit impressions, or cigarettes stamped in violation, may be seized or sealed. If the owner or the owner's agent destroys or removes the seal, that individual may, be subject to a penalty of not more than \$1,000 [N.J. Rev. Stat. 54:40A-32.1].

In addition to any other remedies provided by law, the Director of the Division of Taxation in the Department of the Treasury must assess penalties for violations in accordance with the following schedule:

- a) a penalty of not less than \$2,000 and not more than \$4,000 for the first violation;

- b) a penalty of not less than \$5,000 and not more than \$7,000 for the second violation within a 5-year period;
- c) a penalty of not less than \$8,000 and not more than \$10,000 for the third violation within a 5-year period;
- d) a penalty of not less than \$11,000 and not more than \$13,000 for a fourth violation within a 5-year period; and
- e) a penalty of \$20,000 for a fifth or subsequent violation within a 5-year period. [N.J. Rev. Stat. 54:40A-50].

**New York:** Retail dealer, first violation - \$5,000 to \$25,000; second or subsequent within 3 years \$10,000 - \$35,000

Owner/operator, first violation - \$750 - \$2,000; second or subsequent violation within 3 years \$2,000 - \$6,000 [New York Code, Article 20 § 480-a]

### **Repeated Failures to File Returns or Pay Taxes**

This penalty is generally imposed if there is a pattern by a person of repeated failures to timely file returns or timely pay taxes, and written notice is given that a penalty will be imposed if such failures continue.

**Minnesota:** A penalty of 25 percent of the amount of the tax not timely paid as a result of each such subsequent failure is added to the tax. The penalty can be abated under the abatement authority in section 270C.34 [Minn. Stat. 297F.19 Subdivision. 6].

### **Penalty for Filing a Return That Cannot be Processed**

This penalty is generally imposed when a person files a return or report and it does not contain enough information to properly process the return or report.

**Illinois:** Penalty is the lesser of \$250 or 2 percent of the tax required to be shown due on the return without regard to timely payments or credits. If the return is timely filed but cannot be processed, the taxpayer has 30 days to correct the return before penalty is due. If the return is not filed within 30 days after a notice of non-filing is received, an additional penalty will be imposed equal to the greater of \$250 or 2 percent of the tax shown due on the return without regard to timely payments. The additional penalty may not exceed \$5,000. The penalty will be assessed even if there is no tax due. [Illinois 35 ILCS 735/3-3].

## Estimated Return

This is a penalty that is generally imposed when the department is forced to create an estimated return because a return is not filed.

**California:** Upon the basis of the estimate the board will compute and determine the amount required to be paid to the state, adding to the sum thus fixed a penalty equal to 10 percent. One or more determinations may be made for one or for more than one month [California Revenue and Taxation Code, Section 30221]. If payment is not made within 30 days of the date the determination was issued, an additional penalty of 10 percent will be due [California Revenue and Taxation Code, Section 30264].

If a distributor fails to make payment for stamps or meter register settings when payment is due, the board may compute and determine from any available records and information the amount required to be paid, including interest and penalties. One or more determinations may be made of the amount due for one or for more than one purchase. In making a determination the board may offset overpayments with respect to purchases of stamps or meter register settings against underpayments for purchases and interest and penalties on the underpayments. The board will give the distributor written notice of its determination [California Revenue and Taxation Code, Section 30173].

**Illinois:** Penalty is based on the number of days the tax required to be shown due on the return is late.

- 1 - 30 days: 2 percent or,
- 31 + days: 10 percent

## Failure to File an Amended/Corrected Statement or Return

This is a penalty that is generally imposed when a taxpayers fails to file an amended or corrected return.

**Illinois:** \$5 for each return or statement not timely filed up to a total of \$25,000 during any calendar year. If a return is filed within 60 days of the due date, the penalty may be reduced by 50 percent [Illinois 35 ILCS 735/3-4].

## Personal Liability

States may generally hold a president, vice president, secretary, or treasurer, or other person having control or supervision of, or charged with the responsibility for making returns and payments, personally liable for the failure to comply with the statute. However, the states listed below also had a separate penalty associated with personal liability.

**Illinois:** Amount equal to the total amount of unpaid tax, penalties, and interest. [Illinois 35 ILCS 735/3-7].

**Michigan:** A person, other than a licensee, who is in control or in possession of a tobacco product contrary to the act, or is in control or in possession of an individual package of cigarettes without a stamp in violation of the act, or who offers to sell or does sell a tobacco product to another for purposes of resale without being licensed to do so under the act, shall be personally liable for the tax imposed by the act, plus a penalty of 500 percent of the amount of tax due under the act [MCL 205.428 Section 8 (1)].

**Ohio** Any person required to pay excise tax on OTP, audit sample of business, up to 15 percent penalty in addition to other amounts assessed [O.R.C. 5743.56].

## Failure to Make Accelerated Payments

This penalty is generally imposed when a business fails to make accelerated payments when due.

**Minnesota:** A penalty is imposed equal to 10 percent of the amount of June liability required to be paid in June, less the amount remitted in June. However, the penalty is not imposed if the amount remitted in June equals the lesser of: (1) 90 percent of the actual June liability; or (2) 90 percent of the preceding May's liability [Minn. Stat. 297F.09 Subd. 10 (b)].

## Failure to Pay Electronically

This penalty is generally assessed for failure pay the tax by electronic means (mandated accounts only).

**California:** 10 percent [California Revenue and Taxation Code, Section 30190 (e)].

**Iowa:** The penalty is 5 percent for failure to remit tax payments electronically or if the electronic transmission of a payment is not in an approved format [Iowa Code, §421.27 (7)].

**Ohio:** An additional charge can be imposed that is equal to 5 per cent of the amount of the taxes required to be paid by electronic funds transfer but shall not exceed \$5,000 [O.R.C. 5743.051].

### **Bad Check Penalty**

This penalty is generally imposed when a business has insufficient funds to cover a check that has been written.

**Illinois:** \$25 for each remittance not honored by the financial institution [Illinois 35 ILCS 735/3-7.5].

### **Penalty for Selling Cigarettes Not of Employer's Manufacture**

This penalty is generally imposed when a manufacturer representative sells or exchanges cigarettes that were not produced by the manufacturer that the representative works for.

**New Jersey:** Any manufacturer's representative, who sells or exchanges cigarettes other than those of his employer's manufacture shall be liable to a penalty of not more than \$1,000 for each separate offense [N.J. Rev. Stat. 54:40A-24.1(10)].

### **Selling or Giving Away Cigarettes in Packs of Less than 20 Cigarettes**

Generally this penalty is assessed when cigarettes are sold or given away in a quantity that is less than a pack of 20 cigarettes.

**New Jersey:** Fined not less than \$100 or more than \$500 for each day that a vending machine is determined to be in violation. Fined \$250 for a first offense and \$500 for a second or subsequent offense when a retailer sells a single cigarette or a pack that contains less than 20 cigarettes [N.J. Rev. Stat. 54:40A-4.2].

### **Alteration or Removal and reuse of a tax stamp**

This is penalty is generally imposed when someone removes and sells or possesses stamps that have previously been used or affixed to a pack of cigarettes.

**Iowa:** An aggravated misdemeanor - up to 2 years imprisonment, \$625 - \$6,250 [Iowa Code Title XVI, Subtitle 3, Chapter 903, § 903.1] [Iowa Code, §453A.38].

**Virginia:** First offense - removes or otherwise prepares stamp with intent to use, or buys, sells, offers for sale, or gives away washed or removed or restored

stamps or possesses any washed or restored or removed or altered stamp; reusing stamp; manufactures, buys, sells, offers for sale, or possesses any reproduction or counterfeit stamps provided for in this article, or whoever sells any stamps not affixed to taxable cigarettes - less than 40 revenue stamps up to \$1,000.

Second or subsequent offense of washed/removed stamps (buys, sells, possesses, offers for sale, etc.), or possessing counterfeit stamps more than 40 stamps, up to \$5,000 and, if applicable, the revocation by the Department of Taxation of his wholesale dealer license [Code of Virginia, § 58.1-1015(A) and (B)].

## Possession or Sale of Counterfeit Stamps

This penalty is generally assessed when someone possesses or sells counterfeit stamps.

**New York:** Impose a penalty of not more than \$200 for each 10 unaffixed false, altered or counterfeit cigarette tax stamps, imprints or impressions, or fraction thereof, in the possession or under the control of any person [New York Code, Article 20 § 481 (b)(i)(B)].

**Virginia:** First offense - 40 or more stamps, up to \$2,000. Second or subsequent offense - 40 or more stamps, up to \$50,000 and, if applicable, the revocation by the Department of Taxation of the wholesale dealers license [Code of Virginia § 58.1-1015(D)].

## Civil Penalty for Selling Gray Market Cigarettes

This is a civil penalty that is generally imposed when cigarettes not intend to be sold, distributed, or used in the U.S. are sold, distributed, or used in the United States.

**Illinois:** The department may revoke or suspend the license or licenses of any distributor or secondary distributor or person, and a civil penalty in an amount not to exceed the greater of 500 percent of the retail value of the cigarettes involved or \$5,000 [Illinois 35 ILCS 135/3-10].

**Virginia:** A civil penalty in not to exceed the greater of 500 percent of the retail value of the cigarettes involved or \$5,000 [Code of Virginia, § 58.1-1035. (B)].

## Sales, Distribution of Certain Flavored Cigarettes

Generally this penalty is imposed when a person, an agent, or employee, (or a vending machine) sells, offers for sale, or distributes a cigarette, having a characterizing flavor other than tobacco, clove or menthol.

**New Jersey:** A civil penalty is imposed of not less than \$250 for the first violation, not less than \$500 for the second violation, and \$1,000 for the third and each subsequent violation [N.J. Rev. Stat. 2A:170-51.6].

## Penalty for Advertising Tax is not Included and Assumed by the seller

Generally this criminal charge is imposed when distributor or secondary distributor advertises or states to the public or to any purchaser, consumer or user, directly or indirectly, that the tax or any part thereof imposed will be assumed or absorbed by the distributor or secondary distributor or that it will not be added to the selling price of the cigarettes sold, or if added that it or any part thereof will be refunded.

**Illinois:** Guilty of a Class B misdemeanor [Illinois 35 ILCS 135/9].

## Cost of Collection

In general, this penalty/ fee is typically owed if the tax department sends a request for payment of a final liability and the amount is not paid in full within a certain number of days of the date of the bill. This penalty is imposed to defray the cost of collecting the debt.

**California:** Based on failure to pay - equal to amount of board's costs for collection [California Revenue and Taxation Code, Section 30354.7(a)].

**Illinois:** If the total unpaid amount is less than \$1,000, the penalty is \$30 if it is \$1,000 or more, the penalty is \$100 [Illinois 35 ILCS 735/3-4.5].

## Reimbursement of Investigation and Prosecution Costs

In general, this fee is charged as a way for the department to recoup some of the cost associated with an investigation or prosecution of anyone who has violated the provisions of the law.

**California:** Convicted persons may be charged the costs of investigation and prosecution at the discretion of the court [California Revenue and Taxation Code, Section 30482].



**Iowa:** If taxes have not been paid or reports not filed, as required, the department shall assess against the permit holder or other person, as additional penalty, the reasonable expenses and costs of the investigation and audit [Iowa Code, §453A.30].

**Wisconsin:** If the permit holder fails to provide records in a prescribed format within 30 days after notice the permit holder shall pay the expenses reasonably attributable to a proper examination and tax determination at the rate of \$30 per day of each auditor. The department shall send a bill for expenses and the permit holder shall pay the amount of the bill within 10 days [Wis. Stat. 139.82(4)].

## Failure to Keep Records

This penalty is generally imposed when a business fails to keep proper invoices, books, or records.

**Iowa:** First violation \$200, second violation within 3 years \$500, third or subsequent violation within 3 years, \$1,000 [Iowa Code 453A.31 (1) (b)].

**Virginia:** \$1,000 for each day that the person fails or refuses to allow an audit or inspection of the records [Code of Virginia, § 58.1-1007].

**Wisconsin:** If the records are not revised within 30 days after a notice is given, then the permit holder must pay the expenses reasonably attributable to a proper examination and tax determination at the rate of \$30 per day of each auditor. The secretary shall send a bill for such expenses and the permit holder must pay the amount of such bill within 10 days [Wis. Stat. 139.38 (4)].

## Criminal Charges and Penalties

### False Statement on an Application for License

Generally imposed when someone provides false information on an application for a license or a permit.

**California:** Misdemeanor punishable by imprisonment of up to 1 year in the county jail, or a fine of not more than \$1,000, or both the imprisonment and the fine. [California Business and Professions Code, Section 22973 (a) (5) (retailer) and Section 22977(a) (5) (distributors and wholesalers)].

**Virginia:** Anyone who knowingly and willfully falsifies, conceals or misrepresents a material fact or knowingly and willfully makes a false, fictitious or fraudulent

statement or representation in any application for a stamping permit to the Department shall be guilty of a Class 1 misdemeanor - up to 1 year in jail up to \$2,500, either or both (Code of Virginia, Title 18.2 § 18.2-11(a)) [Code of Virginia, § 58.1-1011].

OTP Distributor's license - Anyone who knowingly and willfully falsifies, conceals or misrepresents a material fact or knowingly and willfully makes a false, fictitious or fraudulent statement or representation in any application for a distributor's license to the department, shall be guilty of a Class 1 misdemeanor - up to 1 year in jail up to \$2,500, either or both (Code of Virginia, Title 18.2 § 18.2-11(a)) [Code of Virginia, § 58.1-1021.04].

### **Altering or Counterfeiting a License**

This criminal charge is generally imposed when a person makes, purchases, or assists in making or purchasing false, counterfeit, or altered licenses, certificate stickers, vending machine discs, or markers, or when a person is in possession of a device used to forge, alter, or counterfeit a license, vending machine disc, or marker.

**Michigan:** A felony punishable by a fine of not more than \$5,000 or imprisonment for not more than 5 years, or both [MCL 205.428 (7)].

**New York:** Any person who falsely or fraudulently makes, alters or counterfeits a registration certificate or sticker required retailer vendor and vending machine register, or causes or procures to be falsely or fraudulently made, altered or counterfeited any such registration certificate or sticker, or knowingly and willfully utters, purchases, passes or tenders as true any such false, altered or counterfeited registration certificate or sticker, and any person who knowingly and willfully makes, causes to be made, purchases or receives any device for forging or counterfeiting any registration certificate or sticker required under the provisions of such section, or who knowingly and willfully possesses any such device, shall be guilty of a class B misdemeanor, fine up to \$500. [New York Pen. §70.00(e) and §80.052] [New York Code, Article 37 §1814. (i)].

### **Tampering with a Stamping Meter**

This is a criminal penalty that is generally imposed when someone tampers with or alters a stamping meter or machine.

**California:** Any person who falsely or fraudulently makes, forges, alters, reuses or counterfeits any stamp or meter impression provided for or authorized under this part, or tampers with any metering machine authorized under this part, or causes or procures to be falsely or fraudulently made, forged, altered, reused,

or counterfeited, any such stamp or meter impression or knowingly and willfully utters, publishes, passes, or tenders as genuine any such false, forged, altered, reused, or counterfeited stamp or meter impression, for the purpose of evading the tax imposed by this part, is guilty of a felony and subject to imprisonment for 2, 3, or 4 years, or to a fine of not less than \$1,000 and not more than \$25,000, or to both fine and imprisonment. [California Revenue and Taxation Code, Section 30473].

**Michigan:** A person who violates a provision of the act for which a criminal punishment is not otherwise provided is guilty of a misdemeanor, punishable by a fine of not more than \$1,000 or 5 times the retail value of the tobacco products involved, whichever is greater, or imprisonment for not more than 1 year, or both [MCL 205.428 (5)].

**Wisconsin:** Class G felony [Wis. Stat. 139.44 (1m)].

### **Penalty for Repeat Convictions**

This penalty is generally imposed when a person is convicted of a violating a provision of the law and is convicted of violating the same provision again.

**New Jersey:** If a person is conviction of a violation, and is again convicted of violating the same provision, the person can be assessed a penalty that is double the maximum penalty which might have been imposed on the first conviction. If the defendant fails or neglects to pay the amount of the penalty, the court shall commit the person to jail for such number of days not exceeding 180 days, as the court shall determine [N.J. Rev. Stat. 54:40A-24].

### **Purchasing Stamps, Not from Department**

This criminal penalty is generally imposed when a person purchases or uses revenue tax stamps from anyone other than the department.

**Virginia:** Any person who purchases revenue stamps from anyone other than the department, or who uses or affixes, or causes to be used or affixed, any revenue stamps not purchased from the department by the owner of the cigarettes being handled or stamped, whether such stamps are genuine or counterfeit, is guilty of a Class 6 felony, 1-5 years imprisonment, or in the discretion of the jury or court trying the case without a jury, up to 12 months, fine up to \$2,500, or both [Code of Virginia, Title 18.2 § 18.2-10(f)]; [Code of Virginia, § 58.1-1009].

## Purchasing Cigarette or Other Tobacco Products from Unlicensed Sellers

This is a criminal penalty that is generally imposed when a retailer purchases cigarettes or tobacco from an unlicensed individual or business.

**Minnesota:** No retailer or sub-jobber shall purchase cigarettes or tobacco products from any person who is not licensed as a licensed distributor or sub-jobber.

- (a) A retailer or sub-jobber who purchases from an unlicensed seller fewer than 5,000 cigarettes or up to \$350 worth of tobacco products is guilty of a misdemeanor (imprisonment for not more than 1 year or to payment of a fine of not more than \$3,000, or both [Minn. Stat. 609.03]).
- (b) A retailer or sub-jobber who purchases from an unlicensed seller 5,000 or more, but fewer than 20,001 cigarettes or more than \$350 but less than \$1,400 worth of tobacco products is guilty of a gross misdemeanor (imprisonment for not more than 1 year or to payment of a fine of not more than \$3,000, or both [Minn. Stat. 609.03 and 297F.20 sub 9]).
- (c) A retailer or sub-jobber who purchases from an unlicensed seller more than 20,000 cigarettes or \$1,400 or more worth of tobacco products is guilty of a felony (imprisonment for not more than 5 years or to payment of a fine of not more than \$10,000, or both [Minn. Stat. 609.03 and 297F.20 sub 9]).

**California:** Misdemeanor. It is a misdemeanor for any retailer to knowingly purchase cigarettes or tobacco products for resale from any person except a licensed distributor or wholesale. Revocation of all sales and use tax permits for 1 year if a retailer is convicted twice in a ten year period [California Revenue and Taxation Code, Section 30478 & Section 30479].

## Trafficking in Cigarettes or Distribution of OTP with Intent to Avoid Payment of Tax

This criminal charge is generally imposed when someone is trafficking in cigarettes or other tobacco products with intent to avoid payment of tax.

**Ohio:** First conviction - felony of the fourth degree [O.R.C. 5743.99(B)], 6-18 months imprisonment [O.R.C. 2929.14(A) (b) (4)] and maximum fine of \$5,000 [O.R.C. 2929.18(A) (3) (a)].

Second conviction - felony of the second degree [O.R.C. 5743.99(B)] 2-8 years [O.R.C. 2929.14(A) (2)], and maximum fine of \$15,000 [O.R.C. 2929.18(A) (2) (c)].

## Sale of Cigarette Packages with Native American Stamp

This is a criminal penalty that is generally imposed when cigarettes with Native American stamps are not sold on a reservation.

### Minnesota:

- a) A retailer doing business off of an Indian reservation who sells or offers to sell more than 200 but fewer than 5,000 cigarettes with Native American stamps is guilty of a misdemeanor (imprisonment for not more than 1 year or to payment of a fine of not more than \$3,000, or both [Minn. Stat. 609.03 and 297F.20 sub 7)(c)].
- b) A retailer doing business off of an Indian reservation who sells or offers to sell 5,000 or more, but fewer than 20,001 cigarettes with Native American stamps is guilty of a gross misdemeanor (imprisonment for not more than 1 year or to payment of a fine of not more than \$3,000, or both [Minn. Stat. 609.03 and 297F.20 sub 7)(c)].
- c) A retailer doing business off of an Indian reservation who sells or offers to sell more than 20,000 cigarettes with Native American stamps is guilty of a felony (imprisonment for not more than 5 years or to payment of a fine of not more than \$10,000, or both [Minn. Stat. 609.03 and 297F.20 sub 7)(c)].

## Failure to Keep Records

This criminal penalty is generally imposed when a business fails to keep proper invoices, books, or records.

**South Dakota:** Must go through the circuit court as disobedience [SDCL 10-50-45.]

## General Catch - All Penalties and Criminal Charges

It is possible that JD Michael has listed “No specific penalty found” when a penalty may exist because some state statutes do not list a specific penalty for a particular violation but may have generic “catch-all” provisions that simply state, for example, “A person who violates a provision of the act for which a criminal punishment is not otherwise provided is guilty of a misdemeanor, punishable by a fine of not more than \$1,000 or 5 times the retail value of the tobacco products involved, whichever is greater, or imprisonment for not more than 1 year, or both.” The states where these types of statements were found are listed below.

**Minnesota:** Other penalties. A violation of this chapter unless otherwise specified is a misdemeanor. [Minn. Stat. 297F.20 subd. 12].

*Punishment When Not Otherwise Fixed*

If a person is convicted of a crime for which no punishment is otherwise provided the person may be sentenced as follows:

- (1) If the crime is a felony, to imprisonment for not more than 5 years or to payment of a fine of not more than \$10,000, or both; or
- (2) If the crime is a gross misdemeanor, to imprisonment for not more than 1 year or to payment of a fine of not more than \$3,000, or both; or
- (3) If the crime is a misdemeanor, to imprisonment for not more than 90 days or to payment of a fine of not more than \$1,000, or both; or
- (4) If the crime is other than a misdemeanor and a fine is imposed but the amount is not specified, to payment of a fine of not more than \$1,000, or to imprisonment for a specified term of not more than 6 months if the fine is not paid. [Minn. Stat. 609.03].

**California:** Misdemeanor, fine is \$5,000, or imprisonment not exceeding 1 year in a county jail, or both the fine and imprisonment [California Business and Professions Code, Section 22981].

Misdemeanor for any violation of the laws governing cigarettes and OTP [California Revenue and Taxation Code, Section 30477].

**Iowa:** Unless specified, for any violation - simple misdemeanor, imprisonment up to 30 days; \$65 - \$625 fine; or both fine and imprisonment. [Iowa Code Title XVI, Subtitle 3, Chapter 903.1a] [Iowa Code, §453A.50 (2)].

**New Jersey:** Subject to any penalties and interest in the State Tax Uniform Procedure Law, R.S.54:48-1 et seq. Unpaid penalties and interest may be determined, assessed, collected and enforced in the same manner as the tax imposed. [N.J. Rev. Stat. 54:40B-13].

In addition to any other remedies provided by law, the Director of the Division of Taxation in the Department of the Treasury shall assess penalties for violations in accordance with the following schedule:

- a) a penalty of not less than \$2,000 and not more than \$4,000 for the first violation;
- b) a penalty of not less than \$5,000 and not more than \$7,000 for the second violation within a 5-year period;
- c) a penalty of not less than \$8,000 and not more than \$10,000 for the third violation within a 5-year period;
- d) a penalty of not less than \$11,000 and not more than \$13,000 for a fourth violation within a 5-year period; and

- e) a penalty of \$20,000 for a fifth or subsequent violation within a 5-year period. [N.J. Rev. Stat. 54:40A-50].

**North Dakota:** Class A misdemeanor and up to 1 year's imprisonment; \$3,000 fine, or both [North Dakota Century Code, 57-36-33] [North Dakota Century Code, Title 12.1, Criminal Code, Chapter 12.1-32-01(5)].

**Ohio:** No other penalty specified for violation of tax law or administrative regulations, misdemeanor, fourth degree misdemeanor of the fourth degree [O.R.C. 5743.99(F)], up to 30 days imprisonment [O.R.C. 2929.24(A) (4)] and maximum fine of \$250 [O.R.C. 2929.28(A) (2) (a) (4)].

**Michigan:** A person who violates a provision of the act for which a criminal punishment is not otherwise provided is guilty of a misdemeanor, punishable by a fine of not more than \$1,000 or 5 times the retail value of the tobacco products involved, whichever is greater, or imprisonment for not more than 1 year, or both [MCL 205.428 (5)].

## Sanctions

### Denial of Stamping Discount

This sanction is generally imposed when a cigarette distributor has outstanding debt, has failed to file the required returns or reports or, has violated a provision of an act. Discounts are denied on further purchase of cigarette tax stamps or impressions for such period of time as the taxing authority may determine.

**Ohio:** Discounts can be denied after a 10-day notice [O.R.C. 5703-15-06].

### Failure to Pay Electronically

This sanction is generally assessed for failure pay the tax by electronic means.

**Illinois:** The department may refuse to sell cigarette tax stamps to any person who does not comply [Illinois (35 ILCS 130/3)].

## Prohibited from Purchasing, Possessing, or Selling Any Cigarettes or OTP

This sanction is generally imposed when a retailer possesses or sells cigarettes on which the tax imposed has not been paid or accrued to a licensed wholesaler, secondary wholesaler, or unclassified acquirer. The sanction requires that the retailer be prohibited from purchasing, possessing, or selling any cigarettes or OTP for a period of time.

**Illinois:** No specific sanction found for retailers. However, distributors who have delinquent accounts are placed on a stop stamp list and distributors cannot purchase stamps until all returns and taxes due are filed and paid. [Illinois (35 ILCS 130/3)].

**Michigan:** A wholesaler, secondary wholesaler, or unclassified acquirer cannot sell cigarettes or OTP to a retailer after receipt of notice from the department that the retailer is prohibited from purchasing tobacco products. Any cigarettes or OTP found on the premises of the retailer during the period of prohibition are considered contraband and subject to seizure and constitute an additional improper possession. The retailer is prohibited from purchasing cigarettes or tobacco for a period of not more than 6 months for a first violation; for a second violation within a period of 5 years, for a period of at least 6 months and not more than 36 months; and for a third or subsequent violation within a period of 5 years, for a period of at least 1 year and not more than 5 years. [MCL 205.429 Section 9 (8)].

## Requiring a Surety Bond

This sanction is generally imposed when a licensed permit holder fails to pay any tax, penalty, or interest that is due.

**Michigan:** Bond is required in the amount of not less than \$1,000 or more than \$25,000 if a taxpayer has failed, refused, or neglected to pay any tax or interest or penalty upon a tax or has attempted to evade the payment of any tax or interest or penalty upon a tax by means of petition in bankruptcy, or if the taxpayer is a corporation and the department has reason to believe that the management or control of the corporation is under persons who have failed to pay any tax or interest or penalty upon a tax under this act [MCL 205.53 (1)].



## **Informant's Share of Tax or Penalty**

This is not really a sanction. This is an incentive for someone to notify the department when illegal activity is taking place.

**Ohio:** Informant's share of tax or penalty 20 percent of net amount received from forfeited cigarettes up to \$10,000 [O.R.C. 5743.44].

## **Trafficking in Cigarettes or Distribution of OTP with Intent to Avoid Payment of Tax**

This sanction is generally imposed when someone is trafficking in cigarettes or other tobacco products with intent to avoid paying the tax.

**Ohio:** If person was operator of motor vehicle used, 30-36 months driver's license suspension [O.R.C. 5743.99(G)].

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<sup>1</sup> California Business and Professional Code Section 22977.2, Cigarette and Tobacco Products Licensing Act Law, Chapter 3, License for Wholesalers and Distributors of Cigarette and Tobacco Products, Section 22977.2, 2 (b), (a), Updated 2013, <http://www.boe.ca.gov/lawguides/business/current/btlg/vol3/ctplal/ctplal-22977-2.html>, (accessed 15 December 2013).

New York Tax Law § 480-a, New York, Article 20, Section 480-A, 1 (e), Retail dealer and vending machine registration, <http://codes.lp.findlaw.com/nycode/TAX/20/480-a> (accessed 15 December, 2013).

<sup>2</sup> A cigarette and tobacco products tax survey was designed, and administered during the first two weeks of November 2013. The survey was distributed by e-mail to 46 state revenue research offices. Nineteen responses were received.

<sup>3</sup> W. Orzechowski and R. C. Walker, *The Tax Burden on Tobacco, Historical Compilation*, vol. 47 (Arlington, VA: Orzechowski and Walker, 2012). Unless specified otherwise, the source for the historical-tax-rate information is Orzechowski and Walker.

<sup>4</sup> ABC Inc., WLS-TV/DT Chicago, IL, “Chicago Budget Approved by City Council, Includes Tobacco Tax Hike, *Chicago News*, 26 November 2013, <http://abclocal.go.com/wls/story?id=9340418> (accessed 10 December 2013).” In Chicago, Emanuel's approved 2014 budget includes an increase on cigarette taxes of 50 cents a pack (instead of the initially proposed 75 cents), which gives the city the highest combined state and local tax in the country.”

<sup>5</sup> Ann Boonn, “State Cigarette Excise Tax Rates & Rankings”, *Campaign for Tobacco-Free Kids*, 1 August 2013, <http://www.tobaccofreekids.org/research/factsheets/pdf/0097.pdf> (accessed 16 November 2013).

<sup>6</sup> Frank J. Chaloupka et al., “Tax, Price and Cigarette Smoking: Evidence from the Tobacco Documents and Implications for Tobacco Company Marketing Strategies”, *Tobacco Control* 11, supplement 1 (2002), BMJ Publishing Group Ltd., [http://tobaccocontrol.bmj.com/content/11/suppl\\_1/i62.full#aff-1](http://tobaccocontrol.bmj.com/content/11/suppl_1/i62.full#aff-1) (accessed 16 November 2013).

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Jonathan Gruber, Anindya Sen and Mark Stabile, “Estimating Price Elasticities When There Is Smuggling: The Sensitivity of Smoking to Price in Canada”, *Journal of Health Economics* 22 (2003) 821–842, <http://economics.mit.edu/files/115> (accessed 16 November 2013).

<sup>7</sup> Ann Boonn, “State Cigarette Excise Tax Rates & Rankings”, *Campaign for Tobacco-Free Kids*, 1 August 2013, <http://www.tobaccofreekids.org/research/factsheets/pdf/0097.pdf> (accessed 16 November 2013).

<sup>8</sup> The State of Minnesota and Blue Cross and Blue Shield of Minnesota vs. Philip Morris Incorporated et al., court file no. C1-94-8565, Second Judicial District Court, Ramsey County, Minnesota, judgment 8 May 1998, <http://www.publichealthlawcenter.org/sites/default/files/resources/mn-settlement-agreement.pdf>. (accessed 16 November 2013). Brands covered by the settlement are referred to as settlement brands. Brands not covered by the settlement are referred to as nonsettlement brands.

<sup>9</sup> Minnesota Department of Revenue, Cigarette Tax > What's New > Rate Increase”, *Frequently Asked Questions*, <http://www.revenue.state.mn.us/Pages/FAQ.aspx?WebId=ec640ae0-bae5-4763-9c0f-edf63e27507e&Owner=Cigarette%20Tax&Topic=What%27s%20New&SubTopic=Rate%20Increase> (accessed 3 December 2013).

<sup>10</sup> Illinois Department of Revenue, Research Division, “Monthly Revenue Report”, page 5, December 2012, <http://www.revenue.state.il.us/AboutIdor/TaxResearch/DecemberFY2013RevenueReport.pdf>, (accessed

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16 November 2013). Illinois increased its cigarette tax effective June 24, 2012. It took almost 6 months for sales to normalize.

<sup>11</sup> A floor tax means that retailers, distributors and sub jobbers are required to pay a one-time floor stocks tax on all stamped cigarette and unaffixed stamps in their possession.

<sup>12</sup> Data is not available to definitively answer either of these questions, either in Minnesota or any other state. The major impediment appears to be that there is no reliable data available for cigarette and tobacco consumption. In addition, volume of illicit product can only be estimated.

<sup>13</sup> Regressing tax rates on elasticity of demand yields an adjusted R-squared of 0.63. What this implies is that 63 percent of the variation in elasticity of demand figures can be explained by tax rates.

<sup>14</sup> The correlation coefficient (a measure of the interdependence between two variables) for elasticity of demand and the percent of bordering states with lower tax rates is 0.75.

<sup>15</sup> It was not possible to use a case study approach for other tobacco products as Illinois' tax changes were not comparable to Minnesota's.

<sup>16</sup> Frank J. Chaloupka, "Monitoring Illicit Trade and Impacts on Tobacco Use", Centers for Disease Control and Prevention, Combating the Illicit Tobacco Trade Meeting (Atlanta, GA: 15 July 2013).

<sup>17</sup> States originally selected for inclusion in the survey: California, Illinois, Iowa, Minnesota, New Jersey, New York, North Dakota, Ohio, South Dakota, Virginia and Wisconsin. Illinois and Iowa declined to participate in this survey and New York State was not sure if they would be able to complete the survey within the timeframe required to complete the report. In order to increase the survey sample size, Michigan, Montana, and New York City were approached and agreed to complete the survey. New York State did respond.

<sup>18</sup> MDOR has the legal authority to require a surety bond for the payment of stamps but has not traditionally requested it

<sup>19</sup> Joe Fitz, "Ongoing Compliance Improvement Benefits (AB 71 and the New Stamp) Evaluated at Fiscal Year 2010-11 Tax Rates", California Board of Equalization, Research and Statistics Section, 11 April 2011, <http://www.boe.ca.gov/info/pdf/AB71-04-11-11.pdf> (accessed 16 November 2013).

<sup>20</sup> National Conference of State Legislatures, "State-Tribal Collaboration", <http://www.ncsl.org/research/state-tribal-institute/state-tribal-collaboration.aspx> (accessed 1 December 2013).

<sup>21</sup> New Jersey Department of the Treasury, "A Guide to the Enforcement of the New Jersey Cigarette Tax Act R-9/12", <http://www.state.nj.us/treasury/taxation/pdf/pubs/misc/ocicigs.pdf> (accessed 4 December 2013).

<sup>22</sup> New Jersey Department of the Treasury, Division Of Taxation Technical Bulletin TB-21(R) Issued: 12-2-13, "Interest Rate Assessed For January 1 – December 31, 2014", (accessed 4 December 2013) <http://www.state.nj.us/treasury/taxation/pdf/pubs/tb/tb21v.pdf>

<sup>23</sup> New Jersey Department of the Treasury, "A Guide to the Enforcement of the New Jersey Cigarette Tax Act R-9/12", <http://www.state.nj.us/treasury/taxation/pdf/pubs/misc/ocicigs.pdf> (accessed 4 December 2013).

<sup>24</sup> Campaign for Tobacco-Free Kids, "Spending on Tobacco Prevention: Minnesota", *U.S. State and Local Issues*, 3 December 2013, [http://www.tobaccofreekids.org/what\\_we\\_do/state\\_local/tobacco\\_settlement/minnesota](http://www.tobaccofreekids.org/what_we_do/state_local/tobacco_settlement/minnesota). (accessed 4 December 2013).

<sup>25</sup> Campaign for Tobacco Free Kids, "Broken Promises to Our Children, the 1998 State Tobacco Settlement 15 Years Later", *U.S. State and Local Issues*, 16 December 2013, [http://www.tobaccofreekids.org/what\\_we\\_do/state\\_local/tobacco\\_settlement/minnesota](http://www.tobaccofreekids.org/what_we_do/state_local/tobacco_settlement/minnesota)

(accessed 17 December 2013). 2014 estimates suggest that Minnesota will increase funding to 36.4 percent of the CDC recommended level. Page | 236

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- <sup>28</sup> Brian A. King, Shanta R. Dube, & Michael A. Tynan, “Flavored Cigar Smoking Among U.S. Adults: Findings From the 2009–2010 National Adult Tobacco Survey”, *The Journal Nicotine & Tobacco Research*, 2013 Feb;15(2):608–14, Office on Smoking and Health, National Center for Chronic Disease Prevention and Health Promotion, Centers for Disease Control and Prevention, Atlanta, GA, [http://search.yahoo.com/r/\\_ylt=A0oG7nNx8KIShS8AyqZXNyoA;\\_ylu=X3oDMTEzOTdtbTMwBHNIYwNzcgRwb3MDMgRjb2xvA2FjMgR2dGkA1ZJUDI2NF8x/SIG=12tkpk59t/EXP=1386897649/\\*\\*http%3a/www.blumenthal.senate.gov/download/tobacco-data-on-flavored-cigars](http://search.yahoo.com/r/_ylt=A0oG7nNx8KIShS8AyqZXNyoA;_ylu=X3oDMTEzOTdtbTMwBHNIYwNzcgRwb3MDMgRjb2xvA2FjMgR2dGkA1ZJUDI2NF8x/SIG=12tkpk59t/EXP=1386897649/**http%3a/www.blumenthal.senate.gov/download/tobacco-data-on-flavored-cigars), (accessed 30 November 2013).
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- <sup>31</sup> Brian A. King et al., “Flavored-Little-Cigar and Flavored-Cigarette Use Among U.S. Middle and High School Students”, Society for Adolescent Health and Medicine, Elsevier Inc., epub ahead of print, *The Journal of Adolescent Health* (2013 Sep 17. pii: S1054-139X(13)00415-1. doi: 10.1016/j.jadohealth.2013.07.033), <http://www.ncbi.nlm.nih.gov/pubmed/24161587> (accessed 30 November 2013).
- <sup>32</sup> Jessica Kuehne, “Where Do Youth Smokers Get Their Cigarettes?”, *Campaign for Tobacco-Free Kids*, 15 May 2007, <http://www.pactonline.org/sites/default/files/Youth%20Access-TFK.pdf> (accessed 6 December 2013).
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- <sup>34</sup> Information contained in this section was compiled from interviews with companies, publications received from stamping companies, and industry research
- <sup>35</sup> Definitions come from Framework Convention Alliance, “The Use of Technology to Combat the Illicit Tobacco Trade: Coding, Verification, Tracking and Tracing of Tobacco Products and Tax, Stamps, [2007], [http://www.fctc.org/index.php/component/docman/doc\\_download/124-technology-and-the-fight-against-illicit-tobacco-trade?Itemid=77](http://www.fctc.org/index.php/component/docman/doc_download/124-technology-and-the-fight-against-illicit-tobacco-trade?Itemid=77) (accessed 27 November 2013) unless otherwise specified.
- <sup>36</sup> *Wikipedia*, “Data Matrix”, [http://en.wikipedia.org/wiki/Data\\_Matrix](http://en.wikipedia.org/wiki/Data_Matrix) (accessed 14 December 2013).
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<sup>48</sup> John W. Colledge III, Tracing and Tracking and the Draft Illicit Trade Protocol, *Campaign for Tobacco-Free Kids*, 8 February 2012, [http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&cad=rja&ved=0CCsQFjAA&url=http%3A%2F%2Fwww.tobaccocontrollaws.org%2Ffiles%2Fpresentations%2FCTFK-ILC\\_Tracing\\_and\\_Tracking\\_Webinar\\_PPT\\_Presentation.pps&ei=2rCWUtlC6OMygHw1oGABg&usg=AFQjCNGjae-957MM1Gy8OjEKS4hFL7fYwQ&bvm=bv.57155469,d.aWc2](http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&cad=rja&ved=0CCsQFjAA&url=http%3A%2F%2Fwww.tobaccocontrollaws.org%2Ffiles%2Fpresentations%2FCTFK-ILC_Tracing_and_Tracking_Webinar_PPT_Presentation.pps&ei=2rCWUtlC6OMygHw1oGABg&usg=AFQjCNGjae-957MM1Gy8OjEKS4hFL7fYwQ&bvm=bv.57155469,d.aWc2), (accessed 12 December 2013).

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<sup>52</sup> Bureau of State Audits, California State Auditor, Board of Equalization: Its Implementation of the Cigarette and Tobacco Products Licensing Act of 2003 Has Helped Stem the Decline in Cigarette Tax Revenues, but It Should Update Its Estimate of Cigarette Tax Evasion (29 June 2006, Report no 2005-034), <http://www.bsa.ca.gov/pdfs/reports/2005-034.pdf>, (accessed 27 November 2013).

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<sup>59</sup> Framework Convention Alliance, “The Use of Technology to Combat the Illicit Tobacco Trade: Coding, Verification, Tracking and Tracing of Tobacco Products and Tax, Stamps”, [2007], [http://www.fctc.org/index.php/component/docman/doc\\_download/124-technology-and-the-fight-against-illicit-tobacco-trade?Itemid=77](http://www.fctc.org/index.php/component/docman/doc_download/124-technology-and-the-fight-against-illicit-tobacco-trade?Itemid=77) (accessed 27 November 2013). Information provided to FCA by Charles Finkel, SICPA Company, 20 November 2007.

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<sup>62</sup> Jason Scott, “Australia to Raise Tobacco Tax to Narrow Budget Shortfall”, *Bloomberg*, 1 August, 2013 <http://www.bloomberg.com/news/2013-07-31/australia-to-raise-tobacco-excise-to-narrow-budget-shortfall.html> (accessed 17 November, 2013).

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<sup>65</sup> Brazil was selected for the study because of its innovative practices at the manufacturing level of the supply chain.

<sup>66</sup> Framework Convention Alliance, “The Use of Technology to Combat the Illicit Tobacco Trade: Coding, Verification, Tracking and Tracing of Tobacco Products and Tax, Stamps, [2007], [http://www.fctc.org/index.php/component/docman/doc\\_download/124-technology-and-the-fight-against-illicit-tobacco-trade?Itemid=77](http://www.fctc.org/index.php/component/docman/doc_download/124-technology-and-the-fight-against-illicit-tobacco-trade?Itemid=77) (accessed 27 November 2013).

<sup>67</sup> “Countries where Vaping is Banned and Why?”, *Ecigarettereviwed*, <http://ecigarettereviwed.com/countries-where-vaping-is-banned-and-why> (accessed 30 November 2013).

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<sup>69</sup> Sandro Contenta, “Cigarette smuggling rises in Canada Cigarette smuggling rises in Canada”, *Global Post*, December 4, 2009 06:39 Updated May 30, 2010 12:15, <http://www.globalpost.com/dispatch/canada/091201/cigarettes-smuggling?page=0,1> (accessed 17 November 2013).

<sup>70</sup> Douglas Quan “About 50 contraband tobacco manufacturers operating in First Nations reserves, document reveals”, *Canada.com*, 27 August 2013, <http://www.canada.com/About+contraband+tobacco+manufacturers+operating+First+Nations+reserves+document+reveals/8839766/story.html> (accessed 17 November 2013).

<sup>71</sup> “5 Ottawans arrested in cross-border cigarette smuggling bust, Project O-Titan, led by RCMP, began in 2012”, CBC News 21 June 2013, Last Updated: 21 June 2013, <http://www.cbc.ca/news/canada/ottawa/5-ottawans-arrested-in-cross-border-cigarette-smuggling-bust-1.1340637> (accessed 17 November 2013).

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<sup>72</sup> William Marsden, "Canada's cigarette smuggling corridor " International Consortium for Investigational Journalists, 3 March, 2001, <http://www.icij.org/node/460/canadas-cigarette-smuggling-corridor> (accessed 17 November 2013).

<sup>73</sup> Ibid.

<sup>74</sup> William Marsden, "Canada's boom in smuggled cigarettes", Center for Public Integrity, updated 18 March, 2011, <http://www.publicintegrity.org/2009/03/27/2913/canadas-boom-smuggled-cigarettes> (accessed 17 November 2013).

<sup>75</sup> Alberta Tax and Revenue Administration, Alberta Tobacco Tax Act, Information Circular TTA-2R3,"Offences, Penalties and Enforcement". October 2009, [http://www.finance.alberta.ca/publications/tax\\_rebates/tobacco/tta2.html](http://www.finance.alberta.ca/publications/tax_rebates/tobacco/tta2.html) (accessed 21 November 2013).

<sup>76</sup> William Marsden, "Canada's boom in smuggled cigarettes" Updated 18 March 2011, Center for Public Integrity, <http://www.publicintegrity.org/2009/03/27/2913/canadas-boom-smuggled-cigarettes> (accessed 21 November 2013).

<sup>77</sup> China was selected for inclusion in this survey because it is the largest source of counterfeit product in the US.

<sup>78</sup> "Tobacco Taxes in China", World Lung Foundation, <http://www.worldlungfoundation.org/ht/a/GetDocumentAction/i/6558> (accessed 21 November 2013).

<sup>79</sup> Stephen Wright "IRA's cigarette-smuggling millionaires: Former terrorists flooding the UK with potentially lethal fakes, cheating taxpayers of billions", The Daily Mail, 6 June 2013, <http://www.dailymail.co.uk/news/article-2336865/IRAs-cigarette-smuggling-millionaires-Former-terrorists-flooding-UK-potentially-lethal-fakes-cheating-taxpayers-billions.html> (accessed 27 November 2013).

<sup>80</sup> This would be roughly enough to supply each U.S. smoker with 460 packs of counterfeit Marlboros, Newports or Benson & Hedges

<sup>81</sup> "China's Marlboro country", Organized Crime and Corruption Reporting Project, [https://reportingproject.net/underground/index.php?option=com\\_content&view=article&id=9&Itemid=22](https://reportingproject.net/underground/index.php?option=com_content&view=article&id=9&Itemid=22) (accessed 27 November 2013).

<sup>82</sup> Cezary Jan Strusiewicz, "The 5 Most Insane Examples of Chinese Counterfeiting", *Cracked*, 19 March 2012, [http://www.cracked.com/article\\_19742\\_the-5-most-insane-examples-chinese-counterfeiting\\_p2.html](http://www.cracked.com/article_19742_the-5-most-insane-examples-chinese-counterfeiting_p2.html) (accessed 21 November 2013).

<sup>83</sup> "China's Marlboro country", Organized Crime and Corruption Reporting Project, [https://reportingproject.net/underground/index.php?option=com\\_content&view=article&id=9&Itemid=22](https://reportingproject.net/underground/index.php?option=com_content&view=article&id=9&Itemid=22), (accessed 30 November 2013).

<sup>84</sup> Cezary Jan Strusiewicz, "The 5 Most Insane Examples of Chinese Counterfeiting", *Cracked*, 19 March 2012, [http://www.cracked.com/article\\_19742\\_the-5-most-insane-examples-chinese-counterfeiting\\_p2.html](http://www.cracked.com/article_19742_the-5-most-insane-examples-chinese-counterfeiting_p2.html) (accessed 21 November 2013).

<sup>85</sup> Jolie Ho, "Customs seizes 5m cigarettes smuggled from mainland", *Clear The Air News Tobacco Blog*, August 12 2014, <http://tobacco.cleartheair.org.hk/?p=7642> (accessed 30 November 2013).

<sup>86</sup> Ibid.

<sup>87</sup> "China's Marlboro country", Organized Crime and Corruption Reporting Project, [https://reportingproject.net/underground/index.php?option=com\\_content&view=article&id=9&Itemid=22](https://reportingproject.net/underground/index.php?option=com_content&view=article&id=9&Itemid=22), (accessed 30 November 2013).

<sup>88</sup> Ireland and the U.K. were selected for this survey because they have some of the highest cigarette prices in the world and hence a lot of smuggling activity

<sup>89</sup> EU Cigarette Prices, Tobacco Manufacturer's Association, <http://www.the-tma.org.uk/tma-publications-research/facts-figures/eu-cigarette-prices/>, (accessed 30 November 2013).

<sup>90</sup> Revenue Irish Tax and Customs, <http://www.revenue.ie/en/tax/excise/leaflets/pn1877t.html#b29>



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- <sup>91</sup> Revenue Irish Tax and Customs, <http://www.revenue.ie/en/tax/excise/leaflets/pn1877t.html#sectiond>
- <sup>92</sup> Revenue Irish Tax and Customs, <http://www.revenue.ie/en/tax/excise/leaflets/pn1877t.html#sectiond>
- <sup>93</sup> Spokesman for the Irish Tobacco Manufacturers Advisory Committee, “300k cigarettes seized at Cork Airport in three months”, *The Irish Mirror*, 29 October 2013, <http://www.irishexaminer.com/ireland/300k-cigarettes-seized-at-cork-airport-in-three-months-248145.html> (accessed 30 November 2013).
- <sup>94</sup> “Tobacco tax rise ‘tokenistic’”, *Irish Independent*, 15 October 2013, <http://www.independent.ie/irish-news/tobacco-tax-rise-tokenistic-29662120.html> (accessed 21 November 2013).
- <sup>95</sup> “Retailers Call on Public to ‘Smell a Rat’”, Retailers Against Smuggling, 31 August 2012, <http://www.retailersagainstsmuggling.ie/?cat=4> (accessed 29 November, 2013)
- <sup>96</sup> Patrick Flynn, “Customs steps up smuggling fight with new scanners”, *Irish Examiner*, 6 June 2013 <http://www.irishexaminer.com/archives/2013/0606/world/customs-steps-up-smuggling-fight-with-new-scanners-233358.html> (accessed 29 November 2013).
- <sup>97</sup> U.K. Cigarette Prices, Tobacco Manufacturer’s Association, <http://www.the-tma.org.uk/tma-publications-research/facts-figures/uk-cigarette-prices/>, (accessed 30 November 2013).
- <sup>98</sup> Alana Fearon “Burning money: Rising cost of smokes fueling black market trade” *Irish Mirror*, 29 October 2013, <http://www.irishmirror.ie/news/irish-news/health-news/rising-cost-cigarettes-causing-growth-2650410>, (accessed 21 November 2013).
- <sup>99</sup> Commons Select Committee, Committee to Investigate Tobacco Smuggling, 23 July 2013, <http://www.parliament.uk/business/committees/committees-a-z/commons-select/home-affairs-committee/news/130723-tobacco-new-inquiry/> (accessed 30 November 2013).
- <sup>100</sup> BBC Online, “MPs announce tobacco smuggling inquiry”, BBC News, 25 July 2013, <http://www.bbc.co.uk/news/uk-politics-23451386>, (accessed 29 November 2013).
- <sup>101</sup> Paul Williams and Steve Payne, House of Commons, Oral Evidence, Taken before the Home Affairs Committee, Tobacco Smuggling, Tuesday 5 November 2013, <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmhaff/uc614-i/uc61401.htm>, (accessed 29 November 2013).
- <sup>102</sup> Ukraine was selected for inclusion in the survey because it has been suggested that it is the world leader in cigarette smuggling.
- <sup>103</sup> “Ukraine cigarettes remain among the cheapest in the world”, *Tobacco.org*, <http://archive.tobacco.org/news/317401.html>, (accessed 21 November 2013) and [http://www.progressivenewsletter.com/view\\_news.do?id=30183](http://www.progressivenewsletter.com/view_news.do?id=30183) (accessed November 30, 2013).
- <sup>104</sup> “Slovaks find railway smuggling tunnel to Ukraine”, *Reuters*, 19 July 2012, <http://www.reuters.com/article/2012/07/19/us-slovakia-ukraine-tunnel-idUSBRE86I0ZO20120719> (accessed November 30, 2013).
- <sup>105</sup> “Slovaks find railway smuggling tunnel to Ukraine”, *Reuters*, 19 July 2012, <http://www.reuters.com/article/2012/07/19/us-slovakia-ukraine-tunnel-idUSBRE86I0ZO20120719> (accessed November 30, 2013).
- <sup>106</sup> Key stakeholders taking part in the operation were Europol, Frontex, the Southeast European Law Enforcement Center (SELEC), the World Customs Organization’s Regional Intelligence Liaison Office for Eastern and Central Europe (WCO RILO ECE), and the law-enforcement authorities of several EU Member States (Austria, Germany, Italy, Hungary, the Netherlands, Poland, Romania, and Slovakia)
- <sup>107</sup> “100,000 cigarettes seized during EUBAM’s latest JBCO: Ovidius”, European Union Border Assistance Mission To Moldova And Ukraine, 9 November 2013, <http://www.eubam.org/en/press/news/1697?print=true> (accessed 21 November 2013).

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<sup>108</sup> See California Business and Professional Code Section 22977.2. (a) (B) and New York Code Article 201 480-a (e) for definition of “Long Arm”, (accessed 12 December 2013).

<sup>109</sup> Christian Weiss, CS/CS/SB1840 enrolled, Florida Revenue Estimating Conference, 9 June 2009 [edr.state.fl.us/content/.../tobaccotaxsurcharge/TobaccoTaxSummary.pdf](http://edr.state.fl.us/content/.../tobaccotaxsurcharge/TobaccoTaxSummary.pdf) (accessed 5 October, 2013).

<sup>110</sup> Martha Blumenthal, Cigarette Tax Evasion in Minnesota, Prepared for the Minnesota Department of Revenue, 30 September 2009, Revised October , [http://www.revenue.state.mn.us/research\\_stats/Documents/Cigarette%20Tax%20Gap%20\(Cigarette%20Tax%20Evasion%20in%20MN\).pdf](http://www.revenue.state.mn.us/research_stats/Documents/Cigarette%20Tax%20Gap%20(Cigarette%20Tax%20Evasion%20in%20MN).pdf) (accessed 26 October 2013).

<sup>111</sup> David Merriman, Cigarette Tax Avoidance in the Chicago area: A contribution to the literature, Working Paper, Institute of Government and Public Affairs at the University of Illinois, September 2008. <http://igpa.uillinois.edu/sites/igpa.uillinois.edu/files/documents/WP-MerrimanCigLitter.pdf> (accessed 26 October 2013).

<sup>112</sup> Joe Fitz, Cigarette and Tobacco Products Tax Evasion, California Board of Equalization, 27 June 2007, <http://www.boe.ca.gov/pdf/cig-evasion-07.pdf>, (accessed 26 October, 2013).

<sup>113</sup> Casual cigarette tax evasion by consumers includes Internet purchases, mail order purchases, and cigarettes bought in other states or in other countries but consumed in-state

<sup>114</sup> Gary Fields, “States Go To War on Cigarette Smuggling.” *Wall Street Journal*, 20 July, 2009, <http://online.wsj.com/article/SB124804682785163691.html> (accessed 18 November, 2013)

<sup>115</sup> Luk Joossens et al., The Impact of Eliminating the Global Illicit Cigarette Trade, *Addiction*, September 2010, 105(9):1640-9, <http://www.ncbi.nlm.nih.gov/pubmed/20626371> (accessed 27 October, 2013).

<sup>116</sup> Jess Alderman, A Law Synopsis by the Tobacco Control Legal Consortium, St. Paul, August 2012.

<sup>117</sup> World Health Organization, Framework Convention on Tobacco Control, 2003.

<sup>118</sup> Luk Joossens et al., The Impact of Eliminating the Global Illicit Cigarette Trade, *Addiction*, September 2010, 105(9):1640-9, <http://www.ncbi.nlm.nih.gov/pubmed/20626371> (accessed 27 October, 2013).

<sup>119</sup> National Conference of State Legislatures, “State-Tribal Collaboration”, <http://www.ncsl.org/research/state-tribal-institute/state-tribal-collaboration.aspx> (accessed 1 December 2013).

<sup>120</sup> Joseph Henchman & Scott Drenkard, “Cigarette Taxes and Cigarette Smuggling by State”, Tax Foundation Tax Policy Blog, <http://taxfoundation.org/article/cigarette-taxes-and-cigarette-smuggling-state> (accessed 9 December, 2013).

<sup>121</sup> New York State Department of Taxation and Finance, State Taxpayer Guidance Division, “Court Ruling Allows Implementation of Tax Law Provisions Related to Cigarettes Sold on Indian Reservations to Go Forward”, New York State Department of Taxation and Finance, Technical Memorandum TSB-M-11(4.2)M Miscellaneous Tax TSB-M-11(7.2)S Sales Tax 21 June 2011, [http://www.tax.ny.gov/pdf/memos/multitax/m11\\_4\\_2m\\_7\\_2s.pdf](http://www.tax.ny.gov/pdf/memos/multitax/m11_4_2m_7_2s.pdf) (accessed 9 December 2013).

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<sup>122</sup> North Dakota Indian Affairs Commission and North Dakota Office of State Tax Commissioner, “North Dakota Tax Information for Native Americans and Tribal Governments”, pp. 13–16, June 2012, <http://www.nd.gov/tax/genpubs/tax-info-native-americans-tribal-governments.pdf?20131212132126> (accessed 16 November 2013).

<sup>123</sup> New Jersey Department of the Treasury, “A Guide to the Enforcement of the New Jersey Cigarette Tax Act R-9/12”, September 2012, <http://www.state.nj.us/treasury/taxation/pdf/pubs/misc/ocicigs.pdf> (accessed 4 December 2013).

<sup>124</sup> New Jersey Department of the Treasury, “A Guide to the Enforcement of the New Jersey Cigarette Tax Act R-9/12”, September 2012, <http://www.state.nj.us/treasury/taxation/pdf/pubs/misc/ocicigs.pdf> (accessed 4 December 2013).

<sup>125</sup> State of Michigan, Department of the Treasury, Revenue Administrative Bulletin 2013-5, “Interest Rate”, 4 April, 2013, [http://www.michigan.gov/documents/treasury/RAB2013-5\\_416649\\_7.pdf](http://www.michigan.gov/documents/treasury/RAB2013-5_416649_7.pdf) (accessed 3 December 2013).

<sup>126</sup> New Jersey Division Of Taxation, Technical Bulletin TB-21(R), “Interest Rate Assessed for January 1-December 2014”, December 2013, <http://www.state.nj.us/treasury/taxation/pdf/pubs/tb/tb21v.pdf> (accessed 3 December 2013).

<sup>127</sup> Conversation with North Dakota compliance officer on 3 December 2013.

<sup>128</sup> Ohio Department of Taxation, “Annual Certified Interest Rates”, 15 October 2013, [http://www.tax.ohio.gov/ohio\\_individual/individual/interest\\_rates.aspx](http://www.tax.ohio.gov/ohio_individual/individual/interest_rates.aspx) (accessed 4 December 2013).

<sup>129</sup> New Jersey Department of the Treasury, “A Guide to the Enforcement of the New Jersey Cigarette Tax Act R-9/12”, September 2012, <http://www.state.nj.us/treasury/taxation/pdf/pubs/misc/ocicigs.pdf> (accessed 4 December 2013).