Cigarette Taxes and the Law

Under the federal "Jenkins Act," all vendors who sell cigarettes over the Internet and by mail order are required to register with state tax administrators and to report all sales and shipments to the individual states. Compliance with these requirements by vendors is spotty. Moreover, even when the reports are provided they are of limited use for enforcement purposes and revenue collection by the city and state. When the review of a Jenkins Act report indicates an untaxed transaction that would be subject to New York's use tax, it usually involves a relatively small amount of uncollected tax which must be pursued on a case-by-case basis.

Prompted in part by the limitations of the federal law as a tool for enforcing state and city tax laws, New York State enacted legislation which took effect in 2003 banning Internet and mail-order cigarette sales directly to individual consumers in the state. Under the new law, the only legal non-New York sales for delivery into the state are those to licensed cigarette vendors. The law also prohibited common carriers, such as FedEx and UPS, from delivering Internet and mail order shipments of cigarettes to individual consumers. The U.S. Postal Service, which is subject to federal rather than state law, continues to deliver tobacco products, although those transactions remain subject to the Jenkins Act reporting requirements.[1]

Soon after enactment of the ban, the city's Department of Finance (DOF) and the state's Department of Taxation and Finance began to crack down on Internet tobacco vendors and their customers in an effort to collect millions of dollars in unpaid cigarette taxes. On its Web site, the DOF lists the amount of taxes that have been billed and collected from individuals who brought untaxed cigarettes from various Internet companies. To ensure proper collection of the city cigarette tax, city regulations also require that all registered Internet and mail-order vendors supply the records of sales and shipments to the city, and in some cases the city has sent letters to individual internet cigarette buyers notifying them of the tax owed on their purchases. According to the state Department of Health's Adult Tobacco Survey, there has been a decline in the number of New Yorkers purchasing cigarettes over the Internet between 2002 and 2006, which may indicate that these measures are successful in deterring tax avoidance.[2]

Sales of cigarettes from Indian reservations present another significant tax enforcement problem. A large portion of the Internet sites advertising tax-free cigarettes are operated from sovereign tribal lands in and outside the state of New York, or from duty-free zones. Collection of cigarette taxes, other excise taxes, and sales tax on reservations in New York has long been a contentious legal and political issue, pitting the tribes and smokers who benefit from the lower prices on one side versus other cigarette retailers and the fiscal needs of the state on the other. Because the reservations are considered to be sovereign lands, members of Indian nations residing on them have long been exempted from paying such state excise and sales taxes. What is less settled is the obligation of reservation businesses to collect taxes from non-Indian customers.

In 1994 a U.S. Supreme Court case affirmed the right of the state to assess and collect taxes, including cigarette taxes, on sales by stores on the reservations to non-Indians. Since that decision, efforts to collect cigarette and other excise taxes have been stymied by a combination of technical issues and outright defiance. Civil disobedience, including blockading portions of the New York State Thruway that cross reservation land, led the Pataki Administration to defer enforcement.

Even after additional legislation was passed in 2005 to address outstanding technical matters that had complicated enforcement consistent with the 1994 decision, excise taxes on reservation sales still were not collected, a policy that was criticized by then gubernatorial candidate Elliot Spitzer. The new Governor's budget, released in January 2007, identified $124 million in new cigarette tax revenue that the Spitzer Administration expected to collect on reservation sales in the current state fiscal year. A recent court decision, however, has temporarily enjoined the state from collecting the tax and enforcing the 2005 law, pending development by the state tax department of new procedures and forms consistent with the 2005 legislation. The tax department has not yet published those procedures.

Although various studies have shown that reservations account for a large portion of cigarettes sales, not all of the under-taxed cigarettes are supplied by entrepreneurs in Indian territories. Sellers from low-tax states, such as South Carolina with its 7 cents per pack tax, make significant profit by offering tobacco products to smokers in heavily taxed jurisdictions like New York. Although some of these sales are through the Internet, 800 numbers, and mail order, in many cases buyers travel to the low-tax dealer and load up a car or truck with packs for resale in New York (bootleggers) or for personal consumption.[3] Regardless of any tax paid in the original state, the New York tax is also supposed to be paid if they are resold in New York, except in the case of the two-carton per person exemption for personal use.

END NOTES

[1]Congress alone has jurisdiction over what is delivered via U.S. mail; legislation to ban the cigarettes and other tobacco products from being shipped via the U.S. Postal Service was introduced in the House in July 2007.

[2]Research Triangle Institute. *Fourth Annual Report on New York's Tobacco Control Program*, August 2007, pp. 2-16.

[3] Legal importers of cigarettes for retail sale in New York are also required to have dealers' licenses.