

Testimony
of
Steven Rosenthal
On behalf of
The New York Association of Wholesale Marketers
Before the
U.S. Congress
The Subcommittee on Crime, Terrorism, and Homeland Security
Hearing on
H.R. 4081 “Prevent All Cigarette Trafficking Act of 2007” and
H.R. 5689 the “Smuggled Tobacco Prevention Act of 2008”

Washington, DC
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Thank you Chairman Scott and Ranking Member Gohmert for allowing me to appear today. My name is Steven Rosenthal and I am testifying on behalf of the New York Association of Wholesalers Marketers.

I will begin by saying that the legislation before the subcommittee today is both essential and gratefully endorsed by the cigarette tax agents in New York.

It is important to understand the channel of distribution of cigarettes and the aberrations that lead to contraband sales.

The cigarette manufacturers are licensed federally and upon removal from their bonded warehouses, pay the US excise tax of \$3.90 per carton.

The state licensed tax stamping agent, (distributor) orders cigarettes from the manufacturer based upon an allocation.

The distributor buys tax stamps from its state and applies the stamps to each pack of cigarettes. In New York this stamp includes pre-collected sales tax as well as excise tax.

The licensed retail dealers then purchase from the distributor and pay the required price per carton which includes their jurisdiction's taxes. In New York and 30 other states, the minimum pricing all the way to the consumer is determined by statute.

As the accompanying chart illustrates, the pricing in New York City also includes the addition of New York City excise taxes.

Contraband cigarettes arise in several different ways.

The distributor may sell to a retail establishment in a low taxed jurisdiction that engages in advertising internet sales into highly taxed jurisdictions causing local taxes to be avoided.

The distributor, based on its state laws, may sell to a Native American store unstamped cigarettes and therefore at profit margins of \$1 or less.

The internet establishment may buy cigarettes illegally from untaxed Native American stores or through foreign smuggling.

The Native American or smuggling operations may be counterfeiters and apply phony tax stamps and sell this contraband through to complicit retailers, internet sellers or street merchants. Usually however, the criminal or terrorist operatives are separate organizations buying from these untaxed sources.

Using New York City as an example:

The legitimate licensed retailer pays \$62 for a carton of cigarettes.

The consumer pays \$67.

The smuggler pays \$30 + \$1 for counterfeit stamps = \$31

The complicit retailer pays \$45.00 and sells to the unsuspecting consumer for \$67.

Terrorists are able to make \$14 (\$45 - \$31) per carton.

The internet buyer pays \$30 vs. \$67 buying directly from untaxed sites.

The sovereignty of our Native American and the treaties that we have in place are sacrosanct and must be respected as such. But let's understand that every population has its good guys and bad guys and those treaties are being corrupted by the vast fortunes that are profiteered by a few illegal sellers, providing only insignificant support to the tribes, while instead, funding criminals and terrorists while they accumulate vast, untaxed fortunes.

New York's Native American retailers sell over 30 million cartons of untaxed cigarettes annually. Current law allows states to impose taxes on all sales of cigarettes and other products sold by a tribe that are to non-Native Americans. Yet, it is estimated that there are just 2,500 adult Native American smokers, so clearly the vast majority of cigarettes are being untaxed.

As a result, the largest source of contraband in the Northeast is supplied by New York's Native American stores, often owned by multi millionaires. No better example can be found than the saga of Rodney Morrison, the owner of the Peace Pipe smoke shop on the Poospatuck reservation on Long Island. Mr. Morrison who married into the Unkechaug Nation tribe is on trial for 'a reign of terror', including arson, extortion, murder and multiple violations of the Contraband Cigarette Trafficking Act. To understand the scope of Morrison's criminal operation from illegal cigarette sales, it is important to note that he offered \$56 million in cash for bail. While this is a staggering figure for most criminals, it was a pittance when compared to his \$35 million per month profits from the sales of contraband cigarettes.

Phillip Morris has discontinued the allotments of all of its brands of cigarettes to any distributor that sells to the Peace Pipe smoke shop. However, none of the other major manufacturers have stopped those sales and all the cigarette manufacturers still continue to allocate the tens of millions of cartons that go to New York's other Native stores.

The major cigarette manufacturers require that each of their distributors report all of their sales by customer, brand and packing each week. But curiously, they continue to ship these irrational quantities to Native Americans with that knowledge.

There are basically three methods to these sales:

1. Face to face sales at their locations with consumers.
2. Internet/mail orders with consumers and complicit retailers, both in New York State and throughout the US and Canada. Because of their advertised low untaxed pricing, these sales are a major contributor to the incidence of both adult and youth smoking.

(In 2005, a group of upstate New York teenagers in collaboration with law enforcement conducted an experiment to see if they could get cigarettes over the Internet. Half of their orders were successfully delivered and 90 percent of those were delivered by the United States Postal Service.)

3. Bulk sales to illegal re-sellers. This is a major source of contraband that goes to counterfeit stamping operations and terrorist organizations.

The single driving force behind each of these sales is ‘the differential’. For example, including the latest excise tax increase, a legitimately taxed pack of cigarettes in a licensed New York City store will cost about \$9.00 and if purchased untaxed, (in two or more carton quantities), will come to \$3.00 per pack! For the average smoker, this is a yearly saving of \$3,000 per person.

Although some transactions are directly with consumers, that quantity can be dwarfed by the truck loads of product that are purchased by smugglers and redistributed to counterfeit stamping operations, street merchants and school yard pushers. Many of the criminals that have been apprehended have ties to terrorist organizations. Earlier this month, the largest seizure in New York history of counterfeit stamps and product occurred in Brooklyn and Rafea Al-Nablisi, a Jordanian, was indicted.

Counterfeit stamps serve no purpose without the untaxed/unstamped cartons of cigarettes that easily come from the Native American stores in manageable quantities for illegal affixing. It is much more difficult to obtain and distribute a container load of 50,000 cartons of foreign product. Foreign product is therefore best used for blending within established large scale networks such as our Native American outlets. A Native American store in Western New York was found guilty of such illegal selling after apprehension by the Bureau of Alcohol, Tobacco, Firearms and Explosives.

PACT Act

The Prevent All Cigarette Trafficking Act (HR 4081) is a common-sense approach at eliminating the ability of Internet sites to sell cigarettes and we wholeheartedly support the bill and urge that it be enacted. Some of the key provisions include:

- Strengthening penalties under the Jenkins Act from a misdemeanor to a felony;
- Making tobacco non-mailable through the US Postal Service;
- Empowering each state to enforce federal law against out-of-state sellers who are shipping cigarettes into the state.

In particular, we feel that making tobacco products non-mailable will have a tremendous affect on cigarette smuggling. Currently, common carriers, such as UPS and DHL, have agreed to not ship cigarettes through an agreement with the New York State Attorney General’s office. As a result, tobacco sales over the Internet will cease to exist once the PACT Act is passed, since there will be no means of shipping cigarettes to consumers.

STOP Act

The Smuggled Tobacco Prevention Act of 2008 Act (STOP Act) will create a needed audit trail that will assist cigarette manufacturers and law enforcement in the interdiction of foreign contraband and thereby, add to both federal and local taxation while nourishing our economy.

Other recommendation

When the PACT Act becomes law and tobacco is prohibited through the US Postal Service, I believe that there will be an increase in the demand for cheaper cigarettes. These sales sometimes

involve counterfeit tax stamps and are distributed through street merchants and complicit retail outlets.

If the cigarettes going to **all** New York outlets were tax stamped as New York law requires and the Native Americans given access to legitimate quantities of untaxed product for reservation consumption, this main source of cigarette funding for terrorism would cease. The 1994 Supreme Court ruling has upheld New York's right to this very taxing plan.

We therefore believe that the Contraband Cigarette Trafficking Act needs to be amended to require states taxing cigarettes to identify that taxes have been paid with **tax stamps** applied to every pack. This requirement will greatly assist law enforcement in controlling cross-bordering activities, illicit interstate commerce, and internet sales in violation of PACT.

It is ironic that the Federal Government is called upon to increase state funding for anti-terrorism programs while New York State passes up one billion dollars annually in excise, sales and ancillary taxes with the unintended consequences of funding terrorists; adding to the very costs of these efforts. If highway funding can be withheld for a state's failure to enforce speed limits and minimum age drinking, (South Dakota v. Dole) then why cannot homeland security funding be withheld to the extent of these costs?

In conclusion, I would like to thank Chairman Scott, Ranking Member Gohmert, and the rest of the committee for allowing me to appear before you today on behalf of NYSAWM. In summary, the association would like to express its strong support for both measures and urge their adoption. I would be happy to answer any questions that you may have. Thank you for your important efforts.

Dissecting Cigarette Smuggling in NYC:

Profits per Carton at each level of Operation

