

ENFORCEMENT OF STATE AND LOCAL
TOBACCO EXCISE TAXES AFTER
HEMI GROUP

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I. INTRODUCTION

As states have been turning to tobacco tax increases as a source of revenue, they have found the base for such taxes eroding not only due to declining cigarette consumption but also due to emboldened tax evasion.¹ Large tax differentials between states, combined with the compact size of cigarettes, make the per pack profits from evasion an attractive target. For example, filling up even one car-load with cigarettes in a low-tax state and driving to a high-tax state can lead to a tax evasion profit of up to \$23,000.² Profits of that magnitude attract smugglers and illegal Internet retailers whose activities have begun to carve larger and larger holes in state tax collections.³

Effective state regulation of cigarette markets would be particularly valuable during these economic times. The economic downturn has led to extraordinary declines in state and local tax revenues, placing severe pressure on budgets, with deficits projected into the future.⁴ Most states face

¹ See Gary Fields, *States Go to War on Cigarette Smuggling*, WALL ST. J., July 20, 2009, at A6, available at <http://online.wsj.com/article/SB124804682785163691.html>; Kevin Sack, *States Look to Tobacco Tax to Fill Their Budget Holes*, N.Y. TIMES, Apr. 21, 2008, at A14, available at <http://www.nytimes.com/2008/04/21/us/21tobacco.html>; see also Dion Lefler, *Tax May Not Help Kansas' Budget Woes Enough*, WICHITA EAGLE, Jan. 17, 2010, available at <http://www.kansas.com/news/legislature/story/1140244.html> (emphasizing that smoking cessation is a potential cause of tax revenue declines in Kansas).

² U.S. DEPT OF JUSTICE OFF. OF THE INSPECTOR GEN., REPORT NUMBER I-2009-005, THE BUREAU OF ALCOHOL, TOBACCO, FIREARMS AND EXPLOSIVES' EFFORTS TO PREVENT THE DIVERSION OF TOBACCO, at ii (2009), <http://www.justice.gov/oig/reports/ATF/e0905.pdf> [hereinafter OIG REPORT].

³ See Jerry Markon, *ATF Sting Smokes Out N.J. Cigarette Smuggler*, WASH. POST, June 7, 2009, at PW01, available at <http://www.washingtonpost.com/wp-dyn/content/article/2009/06/02/AR2009060204088.html>.

⁴ Donald Boyd & Lucy Dadayan, *State Tax Decline in Early 2009 Was the Sharpest on Record*, 53 STATE TAX NOTES MAG. 305, 305 (2009) ("Both nominal and inflation-adjusted figures indicate that the first quarter of 2009 marked the largest decline in state tax collections at least since 1963. The same is true for sales tax collections as well as combined state and local tax collections."); Elizabeth McNichol & Nicholas Johnson, *Recession Continues to Batter State Budgets; State Responses Could Slow Recovery*,

deficits, with some states and localities on the verge of bankruptcy.⁵ Some state and local governments have embraced unusual sources and gimmicks to save cash to cover their needs.⁶ Tobacco taxes, in particular, have been viewed as a desirable way to plug budget shortfalls.⁷

Ineffective regulation of cigarette sales, however, undermines effectiveness in collecting tobacco taxes and

CTR. ON BUDGET & POLICY PRIORITIES, Jan. 28, 2010, <http://www.cbpp.org/cms/?fa=view&id=711> ("The worst recession since the 1930s has caused the steepest decline in state tax receipts on record.").

⁵ See McNichol & Johnson, *supra* note 4 ("mid-year shortfalls have opened up in 41 states"). For information regarding various states' levels of debt, see Rick Karlin, *State Deficit Grows to \$8.2B*, TIMESUNION.COM, Feb. 4, 2010, <http://www.timesunion.com/ASPStories/story.asp?StoryID=896617>; Dunstan McNichol, *Pennsylvania Capital Harris-burg Has Bankruptcy Option (Update1)*, BLOOMBERG, Feb. 4, 2010, http://www.bloomberg.com/apps/news?pid=20601015&sid=aqliEs4Ay_a0; Tom Petrino, *New York Governor Sees Risk of California Bond Default*, MONEY & CO. (L.A. TIMES), Nov. 13, 2009, http://latimesblogs.latimes.com/money_co/2009/11/new-york-gov-david-paterson-california-debt-bond-default.html.

⁶ See, e.g., Monica Davey, *Safety Is Issue as Budget Cuts Free Prisoners*, N.Y. TIMES, Mar. 5, 2010, at A1, available at <http://www.nytimes.com/2010/03/05/us/05parole.html?hp> (reporting various states freeing prisoners to meet budget needs); Seth Fiegerman, *Cities Forced to Cancel Christmas*, MAINSTREET, Dec. 11, 2009, <http://www.mainstreet.com/article/lifestyle/cities-forced-cancel-christmas> ("Cash-strapped local governments across the nation have been forced to scale down Christmas celebrations or cut them all together in consideration of increasingly tight budgets. . . . [C]itizens in Fresno, Calif. were heartbroken when they learned that their annual Christmas lighting ceremony was cancelled."); Mark Niesse, *Hawaii Can't Afford Congressional Election*, ABCNEWS.COM, Jan. 9, 2010, <http://abcnews.go.com/US/wireStory?id=9520919> (reporting that Hawaii has considered leaving a congressional seat vacant because of lack of funding to hold an election); Dan Whitcomb & Ciara Linnane, *California Set to Issue IOUs as Fiscal Crisis Weighs*, REUTERS, June 24, 2009, <http://www.reuters.com/article/idUSTRE55O07Q20090625>; News Release, Cal. Dep't of Educ., *Schools Chief Jack O'Connell Joins Educators in Recognition of Record Number of Teachers Receiving Layoff Notices* (Mar. 19, 2009), available at <http://www.cde.ca.gov/nr/ne/yr09/yr09rel40.asp> (attributing teacher layoffs to budget cuts).

⁷ Shaila Dewan, *States Look at Tobacco to Balance the Budget*, N.Y. TIMES, Mar. 20, 1999, at A9, available at <http://www.nytimes.com/2009/03/21/us/21tobacco.html>; Sack, *supra* note 1.

reducing budget woes. The Bureau of Alcohol, Tobacco, Firearms, and Explosives ("ATF") estimates that as much as \$5 billion worth of state cigarette taxes are evaded annually.⁸ Successfully battling this evasion through more effective regulation of tobacco sales will improve state budget positions and help reduce the need for other deficit-reducing measures that could impair economic recovery and reduce state services.⁹ Tax policy can thus serve as a regulatory tool to encourage growth and improve the country's long-term fiscal outlook.

States, however, have been struggling to address this problem effectively.¹⁰ While smuggling is a federal crime,

⁸ Fields, *supra* note 1 (citing the ATF); *see also* News Release, Bureau of Alcohol, Tobacco & Firearms, Cigarette Smuggling – States Lose Millions in Tax Revenue (Mar. 18, 2008), <http://www.atf.gov/press/releases/2008/03/031808-atf-cigarette-smuggling-lost-revenue.html> ("Estimates [of the tax loss] are usually in the billions of dollars per year in the United States."); TE-PING CHEN, CTR. FOR PUBLIC INTEGRITY, TOBACCO UNDERGROUND, SMOKE2U: TOBACCO SALES TAKE OFF IN CYBERSPACE (2008), <http://www.publicintegrity.org/investigations/tobacco/articles/entry/1085/> ("There's a mad dash right now to get money into state coffers," said Timothy Quirin, an analyst at CCH, a private research group that tracks tax laws. "States are looking at any revenue stream they can tap into.'). Estimates of aggregate evasion are imprecise, based on estimation from indirect measures, such as by comparing cigarette sales data from one dataset to consumption data from another or by estimating changes in purchase due to changes in opportunities for tax arbitrage. *See, e.g.*, Mark Stehr, *Cigarette Tax Avoidance and Evasion*, 24 J. HEALTH ECON. 277, 279–80 (2004) (discussing studies).

⁹ *See* McNichol & Johnson, *supra* note 4 ("If revenue declines persist as expected in many states, additional spending and service cuts are likely. . . . Expenditure cuts are problematic policies during an economic downturn because they reduce overall demand and can make the downturn deeper.").

¹⁰ *See, e.g.*, 149 CONG. REC. S16207 (daily ed. Dec. 9, 2003) (statement of Sen. Leahy) ("Criminals are getting away with smuggling and not paying tobacco taxes because of weak punishments, products that are often poorly labeled, the lack of tax stamps and the inability of the current distribution system to track sales from state-to-state."); Kurt M. Ribisl & Rebecca S. Williams, Briefing to the Congressional Task Force on Tobacco and Health: Internet Cigarette Sales 1 (July 17, 2006), http://www.sph.unc.edu/images/stories/news/Ribisl_InternetCigaretteSales.pdf ("Although 33 U.S. states have passed laws regulating Internet and mail order

federal law enforcement has failed to control the problem or focus on illegal Internet retailers.¹¹ New York City, though, has been at the forefront of efforts to use novel litigation strategies to address the problem. In *Hemi Group v. City of New York*, the City tried to bring a civil racketeering suit against an Internet retailer flouting tax collection.¹² This Note considers the results of that decision and argues that, while state and local governments already have the ability to bring civil suits against out of state tax evaders, these suits will not solve their tax collection difficulties. Instead, state and local governments must focus on investigation and policing to ensure the collection of their taxes and improve their ability to regulate cigarette sales.

Part II of this Note provides background information on the evasion of tobacco taxes and the legal framework for combating evasion. Part III discusses *Hemi Group* and its implications for state and local efforts to bring actions to combat tobacco tax evasion. Part IV argues that state civil actions will not be effective in combating evasion and that states should focus on developing investigations into cigarette smuggling. Part V concludes.

cigarette sales, federal policies are needed to prevent tax evasion"); see also Maria Welych, *New York Sting Targets Untaxed Cigarettes; 21 People Arrested*, SYRACUSE.COM, Sep. 18, 2009, http://www.syracuse.com/news/index.ssf/2009/09/new_york_sting_targets_untaxed.html (reporting arrest of twenty-one people by New York for sales of untaxed cigarettes represents largest state "takedown" of evaders to date).

¹¹ See OIG REPORT, *supra* note 2, at vii ("ATF's Alcohol and Tobacco Diversion Program has not kept pace with the level of diversion activity and increasingly complex [tobacco] diversion schemes."); see also *id.* at 23 ("ATF does not have an adequate national diversion program"); ERIC LINDBLOM, CAMPAIGN FOR TOBACCO-FREE KIDS, STATE OPTIONS TO PREVENT AND REDUCE CIGARETTE SMUGGLING AND BLOCK OTHER ILLEGAL STATE TAX EVASION 3 (2008), <http://www.tobaccofreekids.org/research/factsheets/pdf/0274.pdf> (citing GAO 2002 REPORT) (federal enforcement efforts not aimed at Internet retailers).

¹² *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010).

II. EVASION OF STATE TOBACCO EXCISE TAXES

A. Tobacco Excise Taxes

Excise taxes are imposed on the sale of tobacco products at the federal, state, and local level.¹³ Manufactured cigarettes are the most common tobacco product, representing around ninety percent of tobacco consumption.¹⁴ The federal government taxes cigarettes at \$1.01 per pack.¹⁵ Every state and more than 460 local governments impose additional excise taxes, with cigarette taxes varying from \$0.07 per pack in South Carolina to \$4.25 per pack in New York City, with an average of roughly \$1.34 per pack.¹⁶ Most

¹³ See OIG REPORT, *supra* note 2, at i.

¹⁴ Ctrs. for Disease Control & Prevention, Economic Facts About U.S. Tobacco Use and Tobacco Production, http://www.cdc.gov/tobacco/data_statistics/fact_sheets/economics/econ_facts/ (last visited Mar. 1, 2010) (using 2006 data). Other tobacco products are taxed at different rates based on different volumes, so there can be tax advantages to one form of tobacco over another. See, e.g., ANN BOONN & ERIC LINDBLOM, CAMPAIGN FOR TOBACCO-FREE KIDS, THE PROBLEM WITH ROLL-YOUR-OWN (RYO) TOBACCO (2009), <http://www.tobaccofreekids.org/research/factsheets/pdf/0336.pdf>; Erin Rigik, *Roll-Your-Own Climbs Amid Tax Hit*, CONVENIENCE STORE DECISIONS, Jul. 1, 2009, <http://www.csdecisions.com/article/7276>. Other tobacco products include: "roll your own" cigarettes, cigars and cigarillos, loose pipe tobacco, snuff, and chewing tobacco. See, e.g., Cigarette Savers Home Page, <http://www.cigarettesavers.com/> (last visited Mar. 1, 2010) (offering for sale various tobacco products).

¹⁵ See Jason Hanna et al., *Smokers Feeling Abused as Federal Tax Hike Hits*, CNN.COM, Apr. 1, 2009, <http://www.cnn.com/2009/US/04/01/cigarette.tax/>. The tax was \$0.39 prior to 2009. *Id.* A standard pack contains twenty cigarettes and a standard carton contains ten packs. U.S. GEN. ACCOUNTING OFFICE, CIGARETTE SMUGGLING: FEDERAL LAW ENFORCEMENT EFFORTS AND SEIZURES INCREASING 5 (2004), available at <http://www.gao.gov/new.items/d04641.pdf> [hereinafter GAO 2004 REPORT].

¹⁶ See ERIC LINDBLOM, CAMPAIGN FOR TOBACCO-FREE KIDS, STATE CIGARETTE EXCISE TAX RATES & RANKINGS (2010), <http://www.tobaccofreekids.org/research/factsheets/pdf/0097.pdf>; ANN BOONN, CAMPAIGN FOR TOBACCO-FREE KIDS, TOP COMBINED STATE-LOCAL CIGARETTE TAX RATES (2009), <http://tobaccofreekids.org/research/factsheets/pdf/0267.pdf>. But see N. Jamison et al., *Federal and State Cigarette Excise Taxes – United States, 1995–2009*, 58 MORBIDITY & MORTALITY WKLY. REP. 524, 525 May

states collect sales tax in addition to the excise tax.¹⁷ States also receive additional payments from tobacco manufacturers for sales in connection with the 1998 Master Settlement Agreement (“MSA”), which resolved a variety of claims by states’ attorneys general against tobacco companies.¹⁸ These payments may increase the cost of a pack by about \$0.50; however, they are not collected through the sale of cigarette tax stamps but through manufacturer payments based on reported sales volumes for each manufacturer.¹⁹

These excise tax revenues are important to state and local governments. Total state cigarette excise tax revenues for

22, 2009, available at <http://www.cdc.gov/mmwr/pdf/wk/mm5819.pdf> (average around \$1.20 per pack). Note that the New York City rate cited combines state and local tax. Including taxes, the average retail price per pack was \$5.31 in 2008. See ANN BOONN, CAMPAIGN FOR TOBACCO-FREE KIDS, STATE CIGARETTE TAX RATES & RANK, DATE OF LAST INCREASE, ANNUAL PACK SALES & REVENUES, AND RELATED DATA 1 (2009), <http://www.tobaccofreekids.org/research/factsheets/pdf/0099.pdf> [hereinafter BOONN, LAST INCREASE]. In addition, an individual state need not have uniform state tax rates. For example, Arkansas has lower excise tax rates in some border cities. See ARK. CODE ANN. §§ 26-57-806(b)(1)(A), 26-57-807 (2009); Op. Ark. Attn’y Gen. No. 2009-37 (March 19, 2009), available at <http://ag.arkansas.gov/opinions/docs/2009-037.html>.

¹⁷ Total state sales tax revenues on cigarettes were \$3.8 billion in fiscal year 2008. See ORZECOWSKI & WALKER, THE TAX BURDEN ON TOBACCO, at iv (2008), available at http://www.tobaccoissues.com/getobject.aspx?folder=root/tobaccoissues/excisetaxes&name=Tax_burden_2008_vol_43.pdf.

¹⁸ Manufacturers participating in the settlement make annual payments to states that may be adjusted based on the volume of sales. To prevent manufacturers that did not join the settlement from having a price advantage, the MSA required states to enact laws requiring non-participating manufacturers to make payments to states to be held in escrow for twenty-five years or until states brought claims against those manufacturers, whichever occurs first. See Roger Parloff, *Is the \$200 Billion Tobacco Deal Going Up in Smoke?*, FORTUNE, Mar. 7, 2005, at 126, available at http://money.cnn.com/magazines/fortune/fortune_archive/2005/03/07/8253442/index.htm.

¹⁹ See OIG REPORT, *supra* note 2, at 12–13.

2008 were \$15.4 billion on sales of 16.7 billion taxed packs.²⁰ In some states tobacco taxes can constitute more than four percent of revenue.²¹ Taxes imposed by city and local governments can also be important to their respective revenues. All but four states have increased their tobacco taxes since 2000.²² Tobacco taxes are one of the most politically popular kinds of taxes.²³ Health advocates support tobacco taxes as a way to reduce smoking.²⁴ Tobacco

²⁰ BOONN, LAST INCREASE, *supra* note 16 (includes Washington, D.C.). By way of comparison, for the 12 months ending June, 2009 state tax revenues for all taxes were \$712 billion (excludes Washington, D.C.). See Lucy Dadayan & Donald J. Boyd, *State Tax Revenues Show Record Drop, For Second Consecutive Quarter*, 77 STATE REVENUE REP. 1, 17 (2009), available at https://www.policyarchive.org/bitstream/handle/10207/22078/2009-10-15-SRR_77.pdf?sequence=1. Note that tobacco products could be exempt from state tax when sold on a military base or to a tribe member on a reservation. See Patrick Fleenor, Tax Foundation, Tax Differentials on the Interstate Smuggling and Cross-Border Sales of Cigarettes in the United States, Background Paper No. 16 Executive Summary, <http://www.taxfoundation.org/news/show/582.html> (last visited Mar. 6, 2010) ("The two primary sources of [cigarettes not subject to state tax] are Native American tribal reservations and commissaries on military bases.").

²¹ Howard Chernick, *Cigarette Tax Rates and Revenue*, 49 STATE TAX NOTES MAG. 669, 672 fig.3 (2008).

²² California, Missouri, North Dakota, and South Carolina did not. See BOONN, LAST INCREASE, *supra* note 16, at 1.

²³ See CAMPAIGN FOR TOBACCO-FREE KIDS, VOTERS IN ALL STATES SUPPORT SIGNIFICANT INCREASES IN STATE CIGARETTE TAXES 1 (2010), <http://tobaccofreekids.org/research/factsheets/pdf/0309.pdf>; see also Tony Romm, *States Raise Tobacco Tax, Not Necessarily Revenue*, RICHMOND TIMES-DISPATCH, Jul. 4, 2009, available at http://www2.timesdispatch.com/rtd/lifestyles/health_med_fit/article/I-TOBA0618_20090702-182408/277690.

²⁴ See U.S. GEN. ACCOUNTING OFFICE, INTERNET CIGARETTE SALES: GIVING ATF INVESTIGATIVE AUTHORITY MAY IMPROVE REPORTING AND ENFORCEMENT 6 (2002), available at <http://www.gao.gov/new.items/d02743.pdf> [hereinafter GAO 2002 REPORT]; see also Romm, *supra* note 23, at 2 (stating that after a tobacco tax increase Michigan noticed a jump in calls to its "Tobacco Quit Line"). Cigarette tax increases have been shown to reduce smoking by both adults and adolescents. See ERIC LINDBLOM & ANN BOONN, CAMPAIGN FOR TOBACCO-FREE KIDS, RAISING CIGARETTE TAXES REDUCES SMOKING, ESPECIALLY AMONG KIDS (AND THE CIGARETTE

taxes also have the additional benefit of being less volatile sources of revenue than other state taxes.²⁵ Achieving higher compliance with and revenues from tobacco taxes is often cited as a favored strategy for states to close budget gaps.²⁶

B. Excise Tax Evasion

Evasion of tobacco excise taxes is a growing problem.²⁷ It is estimated that annual evasion of these taxes exceeds \$5

COMPANIES KNOW IT) 1 (2009), <http://www.tobaccofreekids.org/research/factsheets/pdf/0146.pdf> ("Philip Morris: . . . price . . . is the main driving force for quitting." (citation omitted)). Adolescents are particularly price-sensitive in their demand for cigarettes. See Christopher Banthin, *Cheap Smokes: State and Federal Responses to Tobacco Tax Evasion Over the Internet*, 14 HEALTH MATRIX 325, 331 (2004).

²⁵ ERIC LINDBLOM, CAMPAIGN FOR TOBACCO-FREE KIDS, TOBACCO TAX INCREASES ARE A RELIABLE SOURCE OF SUBSTANTIAL NEW STATE REVENUE 1 (2008), <http://tobaccofreekids.org/research/factsheets/pdf/0303.pdf>. Note that while such revenues may not be volatile, they would be expected to decline as overall cigarette consumption declines. See Sack, *supra* note 1 ("Cigarette manufacturers also argue that tobacco taxes make for an unstable revenue source because of declining sales."). But see MATTHEW MEYERS, CAMPAIGN FOR TOBACCO-FREE KIDS, ADULT SMOKING DECLINES HAVE STOPPED, SAYS GOVERNMENT REPORT (2009), <http://www.news-medical.net/news/20091113/Adult-smoking-declines-have-stopped-says-government-report.aspx>; Boyd, *supra* note 4, at 313, tbl.5 (showing total state tobacco sales taxes receipts stable since 2002).

²⁶ See, e.g., Fields, *supra* note 1; Bill Hammond, *Albany Gasbags Are Full of It*, N.Y. DAILY NEWS, Nov. 17, 2009, at 35; Sack, *supra* note 1; Dan Walters, *Smoke Tax on Legislature's Agenda as Fiscal Noose Tightens*, SACRAMENTO BEE, Aug. 14, 2009, 3A, available at <http://www.sacbee.com/walters/story/2108467.html>.

²⁷ See GAO 2004 REPORT, *supra* note 15, at 7 ("The ATF report also notes that cigarette trafficking had become big business by 1999."); States, *Losing \$5 Billion Annually to Cigarette Smuggling, Fight Back*, JOIN TOGETHER, July 23, 2009, <http://www.jointogether.org/news/headlines/inthenews/2009/states-losing-5-billion.html>; see also Affiliated Computer Services, Presentation at the 2008 Annual Meeting of the Federation of Tax Administrators, Tobacco Tax Section: Cigarette/Tobacco Issues = Electronic Filing 2 (Sept. 9, 2008), <http://www.nh.gov/revenue/documents/AlbinM.pdf> ("[C]igarette tax is rapidly becoming the largest area of excise tax fraud in the country . . . Internet Sales (without state tax) are causing major negative impacts to state revenues without recourse or recovery.").

billion.²⁸ Evasion is believed to have grown rapidly in recent years due in part to greater tax arbitrage opportunities, more widespread Internet use, and increasing sophistication of smuggling networks.²⁹ Evasion may also enable additional crime—there have been claims that proceeds from cigarette smuggling are used to fund other illegal activities, including terrorism.³⁰

1. Smuggling

The largest source of evasion may be through basic state tax arbitrage, purchasing cigarettes in a state with low taxes and then smuggling them into a state with high taxes for resale.³¹ The large variation in state tax rates can make this

²⁸ See *supra* note 8.

²⁹ See, e.g., Fields, *supra* note 1 (citing evidence of increasing smuggling for tax arbitrage); Marina Walker Guevara & Kate Willson, *Big Tobacco's New York Black Market*, CENTER FOR PUBLIC INTEGRITY: TOBACCO UNDERGROUND, Dec. 19, 2008, <http://www.publicintegrity.org/investigations/tobacco/articles/entry/1084/>; OIG REPORT, *supra* note 2, at ii; KURT M. RIBISL ET AL., ROBERT WOOD JOHNSON FOUNDATION, POLICY BRIEF ON INTERNET CIGARETTE SALES 1 (2007), http://www.saprp.org/KnowledgeAssets/pdf/InternetCigSales_PolicyBriefReport.pdf.

³⁰ See, e.g., Prevent All Cigarette Trafficking Act of 2009 ("PACT Act"), H.R. 1676, 111th Cong. § 1(b)(3) (as referred to Senate, June 1, 2009) ("[T]errorist involvement in illicit cigarette trafficking will continue to grow because of the large profits such organizations can earn"); Markon, *supra* note 3 ("Federal officials have also linked the smuggling to terrorism since the attacks of Sept. 11, 2001, saying that terrorists use it to fund their activities."); Jeff Cohen, Associate Chief Counsel, ATF, Presentation at the 2009 Annual Meeting of the Federation of Tax Administrators, Tobacco Tax Section, Current ATF Cigarette Diversion Initiatives, at 1 (Aug. 2009), http://www.taxadmin.org/Fta/meet/09_tobacco/papers/Diversion.pdf ("Cigarette diversion has been used to finance terrorist activities and organized criminal organizations . . . [and] cigarette smugglers have been implicated as Money Launderers for drug cartels."). But see *Feds Sell 250M Cigarettes to Nab Smugglers*, CBS NEWS, Jan. 22, 2010, <http://www.cbsnews.com/stories/2010/01/22/national/main6128989.shtml> (quoting a spokesman for the Council on American–Islamic Relations as saying "[u]nfortunately, terrorism has become a sort of a buzzword That's what gets you funding.").

³¹ See MATTHEW C. FARRELLY, CHRISTIAN T. NIMSCH, AND JOSHUA JAMES, RTI INTERNATIONAL, STATE CIGARETTE EXCISE TAXES: IMPLICATIONS

type of smuggling quite profitable, especially given that cigarettes are a valuable commodity by volume.³² A single van-load of cigarettes bought in a low-tax state and brought to New York for resale could lead to upwards of \$90,000 in profit in one trip.³³ Tax arbitrage in small quantities for personal use may not always violate state tax law. For example, Oregon allows individual consumers to import cigarettes tax-free in lots or shipments up to 199 cigarettes.³⁴ Such individual interstate transport is not believed to have a significant impact on tax revenues.³⁵

State taxes may also be evaded entirely through the diversion of cigarettes from the supply chain prior to state tax stamp issuance. After manufacture or importation, cigarettes are sent to a federally-bonded warehouse to receive a federal tax stamp.³⁶ Only then are they distributed to state-licensed wholesalers who apply state stamps ("stamping agents").³⁷ Stamping agents resell tax-paid

FOR REVENUE & TAX EVASION 2 (2003), http://www.rti.org/pubs/8742_Excise_Taxes_FR_5-03.pdf [hereinafter RTI REPORT] ("Studies indicate that such long-distance or organized smuggling of cigarettes accounts for the majority of state tobacco tax evasion . . .").

³² See, e.g., OIG REPORT, *supra* note 2, at ii (explaining that alcohol diversion is less prevalent because alcohol is not as valuable by volume). Relatively low criminal penalties for smuggling may also be a factor. *Id.* at 13. The maximum sentence for a violation of the Contraband Cigarette Trafficking Act is 5 years. 18 U.S.C. § 2344(a) (2006). Cigarettes' high value per unit weight can even make them attractive targets of robbery. See, e.g., PATRICK FLEENOR, TAX FOUNDATION, CALIFORNIA SCHEMIN': CIGARETTE TAX EVASION AND CRIME IN THE GOLDEN STATE: EXECUTIVE SUMMARY (2006), <http://www.taxfoundation.org/research/show/1911.html> (describing robberies of cigarettes and tax stamps from wholesaler).

³³ OIG REPORT, *supra* note 2, at 13.

³⁴ OR. REV. STAT. § 323.060 (2003). One author reports that the typical personal exemption is two to three cartons. Stehr, *supra* note 8, at 279 n.6.

³⁵ See Stehr, *supra* note 8, at 277; RTI REPORT, *supra* note 31, at 2 (explaining that cases of individual smokers traveling to a nearby low-tax state is thought to constitute a "much smaller portion" of evasion than long-distance and organized smuggling).

³⁶ See GAO 2004 REPORT, *supra* note 15, at 3.

³⁷ *Id.* at 3-4.

cigarettes to other wholesalers or directly to retailers.³⁸ Cigarettes on which no state tax has been paid can be obtained by manufacturing counterfeit cigarettes in the U.S., diverting cigarettes from an export warehouse or wholesaler prior to stamping, smuggling imported cigarettes through customs, or purchasing state tax-exempt cigarettes on military bases or Native American reservations.³⁹ These cigarettes can then be sold either without a state stamp or with counterfeit stamps.⁴⁰

³⁸ *Id.* at 4.

³⁹ *See id.* at 3–6, 10; Markon, *supra* note 3; OIG REPORT, *supra* note 2, at 8–9 (discussing the diversion of tobacco products from export warehouses and Native American reservations); MICHAEL LAFAYE, PATRICK FLEENOR, & TODD NESBIT, MACKINAC CENTER FOR PUBLIC POLICY, CIGARETTE TAXES AND SMUGGLING: A STATISTICAL ANALYSIS AND HISTORICAL OVERVIEW 35 (2008), <http://www.mackinac.org/archives/2008/s2008-12.pdf> (military base sales). Export warehouses are federally bonded and ship cigarettes free of both federal and state taxes. GAO 2004 REPORT, *supra* note 15, at 4. Military base sales are exempt from state taxation. Sales on military bases are made through commissaries, which can limit the volume that one can obtain tax-free. Military base sales could be a significant source of evasion in Hawaii. *See* Patrick Fleenor, *How Excise Tax Differentials Affect Interstate Smuggling and Cross-Border Sales of Cigarettes in the United States* 1, 11 (TAX FOUNDATION BACKGROUND PAPER NO. 26, 1998), <http://www.taxfoundation.org/files/4cd5774343c1f82447a1381a01c62980.pdf> (estimating 11.3% of taxable sales lost to military bases in fiscal year 1997 in Hawaii).

⁴⁰ *See* OIG REPORT, *supra* note 2, at i (sold without a stamp); ERIC LINDBLOM, CAMPAIGN FOR TOBACCO-FREE KIDS, THE CASE FOR HIGH-TECH CIGARETTE TAX STAMPS 1 (2009), <http://tobaccofreekids.org/research/fact-sheets/pdf/0310.pdf> (sold with counterfeit stamps). South Carolina, North Carolina, and North Dakota do not require tax stamps on tobacco products. OIG REPORT, *supra* note 2, at 9 n.25. North Carolina has considered reinstating stamps. Gary Robertson, *N.C. Examining Cig Stamps Again to Deter Smuggling*, ASSOCIATED PRESS, Feb. 7, 2010, available at <http://finance.yahoo.com/news/NC-examining-cig-stamps-again-apf-1454640237.html?x=0&.v=1>. South Carolina has the lowest tobacco taxes in the nation, making it ideal as a source for smuggling. *See* LINDBLOM, *supra* note 16.

2. Native American Sources

The sale of cigarettes on Native American reservations, in particular, has been a source of significant evasion in some areas.⁴¹ States do not have the power to tax sales on Native American reservations to registered tribe members.⁴² Sales to non-tribal members can be subject to taxation and generally are.⁴³ States have had great difficulty enforcing these taxes.⁴⁴ In *California Board of Equalization v.*

⁴¹ See, e.g., *New York C-stores Cheer Court Ruling on Indian Tax-Free Cigarette Sales*, CONVENIENCE STORE NEWS.COM, Aug. 31, 2009, http://www.csnews.com/csn/news/article_display.jsp?vnu_content_id=1004007733 (“[New York Association of Convenience Stores] claims rampant cigarette tax evasion [from Native American reservations]—tacitly sanctioned by the Paterson administration—has destroyed mom-and-pop retail stores, deprived the state of \$1 billion a year in desperately needed revenue and undermined the effectiveness of the state's anti-smoking efforts.”); Jennifer Carr, *NYC vs. Tribal Smoke Shops: A Troubling Development in the Ongoing Cigarette Tax Battle*, 50 STATE TAX NOTES MAG. 321, 321 (2008); OIG REPORT, *supra* note 2, at 18. It has been estimated that a third of cigarettes sold in New York State are sold untaxed through reservations, although that figure would include cigarettes sold to tribes for export into other states. *Compare Hearing Before the N.Y. S. Standing Comm. on Investigations and Gov't Operations*, Oct. 27, 2009 (statement of William Comiskey, Deputy Comm'r Office of Tax Enforcement of State of New York Department of Taxation and Finance), at 3, *available at* http://www.tax.state.ny.us/enforcement/criminal_enforcement/senate_written_testimony_102609.pdf (estimating one third of cigarette sales in New York are made through a reservation without tax), *with* Robertson, *supra* note 40 (estimating one half of cigarettes in New York state are sold untaxed through smuggling and Internet sales).

⁴² See *Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation*, 425 U.S. 463, 475 (1976).

⁴³ See *Washington v. Confederated Tribes of Colville Reservation*, 447 U.S. 134, 160 (1980). Florida, Nevada, and New Mexico do not require taxes on sales to non-tribal members. Judy Zelio, *Piecing Together the State-Tribal Tax Puzzle*, NAT'L CONF. OF STATE LEGISLATURES, Apr. 2005, <http://www.ncsl.org/IssuesResearch/BudgetTax/PiecingTogethertheStateTribalTaxPuzzle/tabid/12662/Default.aspx>.

⁴⁴ See OIG REPORT, *supra* note 2, at 28 (director of ATFE field division attributes most of the evasion in his area to untaxed tribal sales); see *Hearing*, *supra* note 41, at 1 (“I want to thank the Committee for inviting

Chemehuevi Indian Tribe, the Supreme Court held that states could require tribes to collect these taxes but did not rule that states had the power to collect the taxes directly.⁴⁵ Many tribal sellers refuse to collect these taxes, arguing that their sovereign status allows them to sell cigarettes tax-free.⁴⁶

me here today to discuss one of the most difficult tax administration and enforcement tasks that we face in New York today, that of cigarette tax collection on the Native American reservations.”). For example, in 2008 sales of untaxed cigarettes on Seneca lands in New York would have amounted to 1,483 cartons per tribal member (amounting to 812 cigarettes per day). Jerry Zremski, *Senecas Confront Tobacco Roadblock*, BUFF. NEWS, Jan. 11, 2010, <http://www.buffalonews.com/home/story/918589.html>.

⁴⁵ See *California Bd. of Equalization v. Chemehuevi Tribe*, 474 U.S. 9, 12 (1985). In any event, states would require individual inspections to determine whether each customer was in fact a tribal member. Some states have entered into agreements with tribes to aid collection or have the tribe charge its own tax to reduce competitive imbalance. See Zelio, *supra* note 43 (describing different types of these agreements). States can enact regulations necessary to the collection of taxes on reservations that do not impose an excessive burden on tribal retailers. *Department of Taxation & Fin. of N.Y. v. Milhelm Attea & Bros.*, 512 U.S. 61, 77–78 (1994). Note that the *Milhelm* Court did not reach the question of whether treaties might limit this power. *Id.* at 78 n.11. In the context of the Contraband Cigarette Trafficking Act (“CCTA”), tribal treaties can be an obstacle to regulation. See *United States v. Fiander*, 547 F.3d 1036, 1037–38 (9th Cir. 2008) (upholding conviction for RICO conspiracy based on CCTA predicate acts, although defendant was protected from prosecution under the CCTA by the Yakama Nation’s treaty).

⁴⁶ Kurt M. Ribisl, Annice E. Kim, & Rebecca Williams, *Sales and Marketing of Cigarettes on the Internet: Emerging Threats to Tobacco Control and Promising Policy Solutions*, in *ENDING THE TOBACCO PROBLEM: A BLUEPRINT FOR THE NATION* 669 (Richard J. Bonnie et al. ed., 2007); see, e.g., Zremski, *supra* note 44 (“Citing the sovereignty of Indian lands, Seneca merchants refuse to collect state taxes on the cigarettes they sell, giving them a huge advantage over convenience stores and other outlets that sell tobacco products at full price. That has made Seneca smoke shops and mail-order cigarette businesses a huge success.”).

3. Internet Sales

Internet sales are another large, growing area of evasion.⁴⁷ Internet retailers buy untaxed cigarettes through one of the above methods or taxed cigarettes in a low-tax state and then sell those cigarettes on-line without charging additional tax.⁴⁸ A substantial percentage of Internet retailers sell tax-free cigarettes from Native American reservations.⁴⁹ Internet retailers can thus offer cigarettes for sale at dramatically lower prices than local retailers.⁵⁰ States cannot require Internet retailers to collect excise taxes. In *Quill Corp. v. North Dakota*, the Supreme Court held that the dormant Commerce Clause and Due Process Clause prevent states from imposing use taxes on companies that maintain no physical presence in the state.⁵¹ Thus,

⁴⁷ See Prevent All Cigarette Trafficking Act of 2009 (“PACT Act”), H.R. 1676, 111th Cong. § 1(b)(9) (as referred to Senate, June 1, 2009) (“[T]he number of Internet vendors in the United States and in foreign countries that sell cigarettes and smokeless tobacco to buyers in the United States increased from only about 40 in 2000 to more than 500 in 2005.”); Chen, *supra* note 8 (“Over the past decade . . . websites catering to tax-dodging smokers have proliferated.”); ERIC LINDBLOM, CAMPAIGN FOR TOBACCO-FREE KIDS, INTERNET SALES OF TOBACCO PRODUCTS—REACHING KIDS AND EVADING TAXES 1 (2008), <http://www.tobaccofreekids.org/research/factsheets/pdf/0213.pdf>; Ribisl, *supra* note 10, at 2; GAO 2002 REPORT, *supra* note 24, at 11.

⁴⁸ See RIBISL, *supra* note 29, at 2.

⁴⁹ See Ribisl, *supra* note 46, at 655 (“In January 2005, among domestic [Internet] vendors, 63.4 percent appeared to have a Native American affiliation.”).

⁵⁰ For example, one study found Internet cigarettes for “about one fifth” the price of cigarettes sold by local retailers in the San Francisco Bay Area. Felicia S. Hodge et al., *American Indian Internet Cigarette Sales: Another Avenue for Selling Tobacco Products*, 94 AM. JUR. PUB. HEALTH 260, 260 (2004).

⁵¹ 504 U.S. 298, 318 (1992). While the Court recognized the tension between its decision and the states’ desire to have out-of-state entities pay their fair share of taxes, *see id.* at 310 n.5, the Court saw a need to balance those concerns against states’ ability to burden interstate commerce, *see id.* at 313. The Court expressed concern that a retailer could be forced to collect taxes for over 6000 state and local taxing jurisdictions. *Id.* at 313 n.6. Changes in technology and state regulation since 1992 have led to

states must collect tax on Internet sales directly from the customer.⁵² States have found it difficult to collect these taxes directly, not only with respect to cigarettes but also for other retail goods sold over the Internet.⁵³ States have shown concern about the impact Internet evasion will have on their ability to collect taxes in the long term.⁵⁴ Even without evading taxes, Internet sales can violate state laws that prohibit the direct mailing of cigarettes to consumers and require the verification of age in tobacco sales.⁵⁵

C. Combating Evasion

States and the federal government have found existing legal tools insufficient to combat evasion.⁵⁶ The primary

calls for the Supreme Court to revisit *Quill*. See, e.g., Jeffrey A. Friedman et al., *The U.S. Supreme Court Should Accept a Nexus Case*, 53 STATE TAX NOTES MAG. 42 (2009).

⁵² Transcript of Oral Argument at 41, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), available at http://www.supremecourtus.gov/oral_arguments/argument_transcripts/08-969.pdf.

⁵³ See *id.*; GAO 2002 REPORT, *supra* note 24, at 13 tbl.1 (providing data on state response rates from efforts to collect taxes directly from purchasers); Kenneth Corbin, 'Amazon Tax' Lands in New York, INTERNET NEWS, Apr. 10, 2008, <http://www.internetnews.com/ec-news/article.php/3740056> (describing state efforts to expand their ability to collect taxes directly from retailers); see, e.g., Michael Hiltzik, *Internet Sales Tax Scofflaws Cheat State*, L.A. TIMES, Dec. 24, 2009, available at <http://articles.latimes.com/2009/dec/24/business/la-fi-hiltzik24-2009dec24>.

⁵⁴ GAO 2002 REPORT, *supra* note 24, at 15; see also Brief for The Campaign for Tobacco-Free Kids as Amicus Curiae Supporting Respondent, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), 2009 WL 3143719, at *7-8 (reviewing studies on estimates of Internet evasion).

⁵⁵ Press Release, Attorney General of Montana, Attorneys General, ATF Join with Credit Card Companies to Prevent Illegal Cigarette Sales Over the Internet (Mar. 17, 2005), <http://www.doj.mt.gov/news/releases/2005/03172005.asp>.

⁵⁶ See Prevent All Cigarette Trafficking Act of 2009 ("PACT Act"), H.R. 1676, 111th Cong. § 1(b)(1) (as referred to Senate, June 1, 2009) ("[T]he sale of illegal cigarettes and smokeless tobacco products significantly reduces Federal, State, and local government revenues, with Internet sales alone accounting for billions of dollars of lost Federal, State, and local tobacco tax revenue each year . . ."); CAMPAIGN FOR TOBACCO-

legal tools for regulating interstate sales and evasion are the Contraband Cigarette Trafficking Act (“CCTA”) and the Jenkins Act.⁵⁷

1. Legal Tools

The CCTA bans large-scale cigarette smuggling. The statute makes it a crime to ship, sell, transport, or possess more than 10,000 cigarettes (500 packs) per month not bearing the tax stamp of the jurisdiction in which they are found.⁵⁸ Violation is a felony punishable by up to five years in prison and seizure of the contraband cigarettes.⁵⁹ CCTA violations are a predicate crime for the Racketeer Influenced and Corrupt Organizations Act (“RICO”), which applies to criminal enterprises.⁶⁰ The ATF considers the usual penalties for a violation of the CCTA alone to be minimal.⁶¹ The statute authorizes state and local governments to sue for an injunction or damages for violation, though some restrictions apply to actions against recognized Native American parties.⁶² Tribe members are still subject to

FREE KIDS, STATE BENEFITS FROM THE PACT ACT (2004), <http://www.tobaccofreekids.org/research/factsheets/pdf/0292.pdf> (outlining the problems the problems to be solved by proposed legislation).

⁵⁷ Jenkins Act, 15 U.S.C. §§ 375–378 (1955); Contraband Cigarette Trafficking Act, 18 U.S.C. §§ 2341–2346 (2006) (“CCTA”); *see also* OIG REPORT, *supra* note 2, at 14. 18 U.S.C. § 2320 (2008) (“Trafficking in counterfeit goods or services”) may be used when the cigarettes on which taxes have been evaded are counterfeit. *See* Cohen, *supra* note 30, at 2.

⁵⁸ 18 U.S.C. §§ 2341(2), 2342; OIG REPORT, *supra* note 2, at 14.

⁵⁹ 18 U.S.C. § 2344(a), (c).

⁶⁰ 18 U.S.C. § 1961(1) (2006). This statute was the basis for claims in *Hemi Group*.

⁶¹ *See* OIG REPORT, *supra* note 2, at 16 (“[C]riminals prosecuted under the Contraband Cigarette Trafficking Act received minimal, if any, prison time and fines that did not affect their operations.”). For example, in *United States v. Conway*, 323 Fed. Appx. 517, 2009 WL 1020433, at *1 (9th Cir. Apr. 16, 2009), defendants were sentenced to probation for CCTA violations involving stipulated tax losses of more than \$4 million.

⁶² 18 U.S.C. § 2346(b). An action may not be brought “against an Indian tribe or an Indian in Indian country.” 18 U.S.C. § 2346(b)(1). New York has been able to bring suit against a wholesaler to prevent the wholesaler from selling unstamped cigarettes to a tribe that the tribe

criminal prosecution for unauthorized untaxed sales.⁶³ Cigarette smugglers might also be prosecutable under money laundering statutes or for mail or wire fraud, although it does not appear that such prosecutions are brought.⁶⁴

The Jenkins Act regulates sales of tobacco products via interstate shipment. Congress passed the Act in 1949 in part to reduce state tax losses resulting from tax arbitrage through mail order interstate cigarette sales.⁶⁵ The Act requires an interstate cigarette retailer to register with states in which it advertises or sells cigarettes and to file a report with the state tax administrator providing the quantity of cigarettes sold to a customer, as well as the customer's name and address.⁶⁶ States can then use these reports to seek tax payments directly from customers. The Act does not require retailers to file these reports with cities or local governments, although they may request copies from their state tax administrator.⁶⁷ Violation of the Act is a federal misdemeanor prosecutable by U.S. Attorneys and punishable by a fine of up to \$1,000 or up to six months in

would then resell illegally. *City of New York v. Milhelm Attea & Bros., Inc.*, 550 F. Supp. 2d 332, 336–37 (E.D.N.Y. 2008), *modified*, No. 06-CV-3620 (CBA), 2009 U.S. Dist. LEXIS 19351 (E.D.N.Y. Mar. 11, 2009).

⁶³ See *United States v. Baker*, 63 F.3d 1478, 1484 (9th Cir. 1995), *cert. denied* 516 U.S. 1097 (1996) (affirming CCTA convictions based on sales of unstamped cigarettes to reservations).

⁶⁴ See Cohen, *supra* note 30, at 3 (money laundering statutes); see, e.g., *United States v. De Fiore*, 720 F.2d 757, 765 (1983), *cert. denied*, 467 U.S. 1241 (1984) (upholding wire fraud conviction for smuggling of cigarettes from North Carolina for resale in New York, when phones were used); *South Florida Cigarette Smuggling Funds Terrorism*, BROWARD-PALM BEACH NEW TIMES, Jun. 30, 2009, at 3–4, <http://www.browardpalmbeach.com/2009-07-02/news/south-florida-cigarette-smuggling-funds-terrorism/4> (observing the extraordinary difficulty of prosecuting smugglers under law governing material support of terrorism).

⁶⁵ *City of New York v. Smoke-Spirits.com*, 541 F.3d 425, 433 (2d Cir. 2008), *rev'd sub nom. Hemi Group v. City of New York*, 130 S. Ct. 983 (2010).

⁶⁶ 15 U.S.C. § 376 (1955).

⁶⁷ See *Smoke-Spirits.com*, 541 F.3d at 433 (noting that New York City has an agreement with New York State to receive copies of the reports).

prison.⁶⁸ A willful violation may serve as the basis for a mail fraud conviction under the theory that a business plan based on state tax evasion can constitute a scheme to defraud.⁶⁹ Unlike the CCTA, the Jenkins Act does not contain a civil enforcement provision for state attorneys general. The ATF contends that the Act applies to Native American tribes, although courts have not yet had to consider the question.⁷⁰

The Jenkins Act has proved of limited effectiveness as an enforcement tool because retailers routinely fail to file the required reports.⁷¹ When contacted and asked to file, retailers often ignore the request.⁷² If a retailer does not file,

⁶⁸ 15 U.S.C. § 377 (1955).

⁶⁹ See, e.g., *United States v. Melvin*, 544 F.2d 767, 770 (5th Cir. 1977), *cert. denied* 430 U.S. 910; *United States v. Brewer*, 528 F.2d 492, 496 (4th Cir. 1975) (“Although using the mails for the interstate sale of cigarettes or other lawful merchandise is in itself an innocent act, it becomes fraudulent when the seller couples it with an intent to transact business in a way that enables his customers to escape taxes by dealing with him.”). However, failure to file might only be fraud on the state to which the report is due and not to a city or locality to which taxes are due. See *Smoke-Spirits.com*, 541 F.3d at 459 n.2 (Winter, J., dissenting) (“[T]here are no cases in which a failure to fulfill one’s obligation to report sales to a state tax authority has been adjudged an act of fraud upon a municipal tax authority.”).

⁷⁰ GAO 2002 REPORT, *supra* note 24, at 18–19; see also *United States v. Smiskin*, No. CR-04-2107-EFS, 2005 WL 2736562, at *1 (E.D. Wash. Oct. 24, 2005) (“It is undisputed that federal laws of general applicability . . . are ‘presumed to apply with equal force to Indians.’”) (citing *United States v. Baker*, 63 F.3d 1478, 1484 (9th Cir. 1995), *cert. denied* 516 U.S. 1097 (1996)), *aff’d* 487 F.3d 1260 (9th Cir. 2007); Jonathan I. Sirios, *Remote Vendor Cigarette Sales, Tribal Sovereignty, and the Jenkins Act: Can I Get a Remedy?*, 42 DUQ. L. REV. 27, 96 (2003) (“[T]he Jenkins Act is likely to be deemed valid as applied against individual Indians and tribes because it does not impose a burden upon what would traditionally be considered a right provided by treaty, nor does it surpass the requirements imposed by the CCTA.”).

⁷¹ GAO 2002 REPORT, *supra* note 24, at 2.

⁷² See *id.* at 13 tbl.1. Note that many Internet retailers are based on Native American reservations, *supra* note 49, and many tribal retailers maintain that their sovereignty exempts them from federal law, *supra* note 46. The Supreme Court does not accept that tribal sovereignty prevents collection of these taxes. *California Bd. of Equalization v. Chemehuevi Tribe*, 474 U.S. 9, 12 (1985).

a state will not necessarily know whether it was required to file, since the retailer might not have made any sales into that state.⁷³ Since penalties for violation are so low, U.S. Attorneys do not have strong incentives to bring prosecutions for failure to file.⁷⁴ Moreover, because a uniform format for filing a report does not exist, filings can be difficult to aggregate or use efficiently when reports occur.⁷⁵ When states contact customers regarding taxes due, the rate of response for payment tends to be low.⁷⁶ When necessary,

⁷³ See GAO 2002 REPORT, *supra* note 24, at 11 n.12.

⁷⁴ *Id.* at 4 (“Both DOJ and ATF suggested that if violations of the Jenkins Act were felonies instead of misdemeanors, U.S. Attorneys’ Offices might be less reluctant to prosecute violations.”); see also *id.* at 3 (two states asked for but did not receive assistance from U.S. Attorneys in enforcing the Act); *id.* at 14–15 (the state of Wisconsin referred a case to the U.S. Attorney for prosecution, but the U.S. Attorney declined to prosecute, recommending that Wisconsin pursue administrative remedies, though Wisconsin did not believe it had available administrative remedies or a way to establish jurisdiction over the violator). But note that such conduct could be prosecuted as mail fraud, see, for example, *United States v. Brewer*, 528 F.2d 492, 496 (4th Cir. 1975), or under the CCTA, see *infra* note 146.

⁷⁵ Cf. Michelle Breidenbach, *Data Mining Helps New York Catch Tax Cheats*, SYRACUSE.COM, Jan. 17, 2010, http://www.syracuse.com/news/index.ssf/2010/01/data_mining_helps_new_york_cat.html (“For at least 15 years, state law has required cigarette wholesalers to report the volume of sales to retailers. The information came on paper and sat mostly untouched in boxes.”). In fact, copies of invoices would be sufficient to satisfy the statutory requirement. See 15 U.S.C. § 376(a)(2) (1955). In *Hemi Group* the City alleged that over 400 Internet retailers sell to New York residents. See Greg Stohr, *New York City Tobacco Tax Suits Limited by Top Court (Update 2)*, BLOOMBERG BUSINESSWEEK, Jan. 25, 2010, <http://www.businessweek.com/news/2010-01-25/new-york-city-tobacco-tax-suits-limited-by-top-court-update2-.html>.

⁷⁶ See GAO 2002 REPORT, *supra* note 24, at 13 tbl.1; ERIC LINDBLOM, CAMPAIGN FOR TOBACCO-FREE KIDS, STATE OPTIONS TO PREVENT AND REDUCE CIGARETTE SMUGGLING AND BLOCK OTHER ILLEGAL STATE TOBACCO TAX EVASION 3–4 (2008), <http://tobaccofreekids.org/research/factsheets/pdf/0274.pdf> (“Even when Internet vendors comply with the Jenkins Act and provide the states with the customer information, going after each individual customer to collect owed taxes is an inevitably time consuming and ineffective process.”).

collecting the taxes from customers who do not respond presents additional significant challenges.⁷⁷

Repeated proposals for new federal legislation have sought to redress the perceived weaknesses in current federal law related to tobacco tax evasion, particularly with respect to Internet sales and Jenkins Act shortcomings.⁷⁸ For example, proposed legislation that has passed the House would strengthen the Jenkins Act by making it a felony to fail to file the reports, providing states with a civil cause of action for violations, and prohibiting the U.S. Postal Service from shipping tobacco products sent by those on a list to be created by the Attorney General of retailers who have not registered under the Jenkins Act.⁷⁹ Separate proposals for amendments to federal law have been urged to target sales tax evasion via the Internet in general.⁸⁰ If enacted and

⁷⁷ Editorial, *See Yes, You Owe That Tax*, N.Y. TIMES, Nov. 26, 2009, at A38, available at <http://www.nytimes.com/2009/11/27/opinion/27fri1.html> ("As a practical matter, unless the taxes are collected by retailers, they are virtually never paid."); cf. MINN. HOUSE OF REP. RESEARCH DEPT., USE TAX COLLECTION ON INCOME TAX RETURNS IN OTHER STATES 12 (2007), <http://www.house.leg.state.mn.us/hrd/pubs/usetax.pdf> (providing information on rates of use tax reporting for states that collect use taxes through income tax returns—on average 1.63% of taxpayers report use tax). States that do not have income taxes can have particular problems collecting use taxes. See, e.g., *State Legislatures Pushing to Tax eCommerce*, ECOMMERCE NEWS, Apr. 12, 2006, <http://www.ecommercenews.org/e-commerce-news-008/0225-041206-ecommerce-news.html> ("Washington state has no income tax, so it's at a disadvantage when trying to collect use taxes on a form due on tax day, said Mike Gowrylow, a spokesman for the state Department of Revenue.").

⁷⁸ See, e.g., Smuggled Tobacco Prevention Act of 2008, H.R. 5689, 110th Cong.; Prevent All Cigarette Trafficking Act of 2007, H.R. 4081, 110th Cong.; Prevent All Cigarette Trafficking Act of 2003, S. 1177, 108th Cong.

⁷⁹ Prevent All Cigarette Trafficking Act (PACT Act) of 2009, H.R. 1676, 111th Cong. § 1(b)(3) (as referred to Senate, June 1, 2009).

⁸⁰ See, e.g., Sales Tax Fairness and Simplification Act, H.R. 3396, 110th Cong. § 4(a)(1) (2007) (proposing to authorize states that joined the Streamlined Sales and Use Tax Agreement to collect taxes directly from certain out-of-state retailers); see also Streamlined Sales Tax Governing Board, Inc., <http://www.streamlinedsalestax.org/> (providing information about the Streamlined Sales Tax Project).

enforced, such legislation would require Internet retailers to collect all applicable taxes from the buyer, which could help remedy evasion through Internet sales.⁸¹

2. Enforcement Responsibilities

The ATF has primary federal authority for investigating and combating evasion of both federal and state tobacco taxes, but its foremost priority is the control of violent crime involving firearms, arson, or explosives.⁸² Tobacco tax evasion is not a high priority for the ATF, and it devotes only two percent of its budget to alcohol and tobacco diversion.⁸³ The Department of Justice's Office of the Inspector General ("OIG") considers this diversion enforcement program inadequate.⁸⁴ The Office of Management and Budget tends to deny the ATF's requests for additional tobacco enforcement funding.⁸⁵ The ATF has, however, been

⁸¹ See Edward Zelinsky, *New York's 'Amazon Law': Constitutional but Unwise*, 54 STATE TAX NOTES MAG. 715, 716 (2009) (supporting federal legislation requiring Internet retailers to collect tax).

⁸² OIG REPORT, *supra* note 2, at iii–iv, 10 n.11. The FBI also has authority to investigate Jenkins Act violations. GAO 2002 REPORT, *supra* note 24, at 8. No FBI section has responsibility for cigarette diversion enforcement. *Id.* at 7. Immigrations and Customs Enforcement works to prevent smuggling into the country. See GAO 2004 REPORT, *supra* note 15, at 10 ("In fiscal year 2003, although there were no appropriations earmarked for the task force, [Immigration and Customs Enforcement] decided to maintain a focus on cigarette smuggling.").

⁸³ That budget ranges from \$16.5–21 million. OIG REPORT, *supra* note 2, at 2. Sixty-eight special agents investigate alcohol and tobacco diversion, though not full time, *id.*, which the OIG describes as a minimal commitment of resources, *id.* at 21. The ATF considers diversion investigations time consuming and a drain on resources. *Id.* at 21, 30. The OIG expressed concern that one specific analyst was the main source of much of the ATF's institutional knowledge regarding diversion investigation, such that the ATF's effectiveness could be imperiled were the analyst to leave. *Id.* at 24 n.49.

⁸⁴ OIG REPORT, *supra* note 2, at 23.

⁸⁵ See, e.g., *id.* at viii (ATF did not receive the requested funding for tobacco diversion programs in 2010 and so did not implement its new initiatives), 41 (OMB rejected ATF's request for funding to create a national strategic plan regarding diversion). Since 2003 the ATF has

bringing more tobacco diversion investigations than it has in the past.⁸⁶

Of course, states need not rely on the ATF. They can also undertake their own enforcement initiatives to combat evasion, such as investigating diversion and prosecuting tax evaders.⁸⁷ They can also take steps to impede smuggling, such as by improving their tax stamp systems or adopting strict and effective record-keeping requirements for retailers, wholesalers, and stamping agents.⁸⁸ While states cannot force out-of-state retailers to collect taxes themselves, states can ban sales of tobacco products by mail directly, though they cannot prevent the U.S. Postal Service from delivering cigarettes to consumers.⁸⁹ States could also bring civil suits under the CCTA, although they have not generally done so.⁹⁰

requested “only slight funding increases” and no additional personnel to address tobacco diversion. *Id.* at 2.

⁸⁶ See Prevent All Cigarette Trafficking Act of 2009 (“PACT Act”), H.R. 1676, 111th Cong. § 1(b)(8) (as referred to Senate, June 1, 2009) (“[T]he number of active tobacco investigations being conducted by the Bureau of Alcohol, Tobacco, Firearms, and Explosives rose to 452 in 2005.”); GAO 2004 REPORT, *supra* note 13, at 8; see also *Federal Government Aggressively Enforces State Tobacco Laws*, SMOKESHOP MAG., Aug. 2009, at 86 (“In recent months, the federal government has initiated significant enforcement actions targeting cigarette distribution and manufacturing companies in what has traditionally been the province of state governments.”). In the past three years, ATF sting operations have led to “about five dozen” tobacco smuggling arrests. See *Feds Sell 250M Cigarettes to Nab Smugglers*, CBS NEWS, Jan. 22, 2010, <http://www.cbsnews.com/stories/2010/01/22/national/main6128989.shtml>.

⁸⁷ See LINDBLOM, *supra* note 76, at 4 (encouraging states to expand the coverage of their smuggling laws by lowering the requirements for number of cigarettes smuggled).

⁸⁸ See *id.* at 1, 4 (discussing tax stamp systems and recommending record keeping requirements); Robertson, *supra* note 40.

⁸⁹ *Brown & Williamson Tobacco Corp. v. Pataki*, 320 F.3d 200, 219 (2d Cir. 2003). For example, New York’s ban on out of state shipments has been upheld by the Second Circuit. *Id.* The major private shipping companies voluntarily agreed to stop shipping cigarettes into New York. Zremski, *supra* note 44.

⁹⁰ See *City of New York v. Golden Feather Smoke Shop Inc.*, No. 08-CV-3966, 2009 WL 2612345, *1 (E.D.N.Y. Aug. 25, 2009) (granting New York City preliminary injunction against several cigarette retailers on

States can employ these tools without relying on the federal government to provide support or needing to wait for additional federal legislation.

With the highest cigarette taxes in the country, New York City has been particularly aggressive in attempting to find legal tools to combat evasion, especially by bringing suits based on novel causes of action.⁹¹ Though not entitled to Jenkins Act reports by statute, the City entered into an agreement with New York State to receive copies of the reports.⁹² In *Hemi Group v. City of New York*, the City tried to sue Internet retailers who failed to file reports under the theory that they had caused City tax losses.⁹³

III. HEMI GROUP

A. Background

In *Hemi Group*, the Supreme Court considered the City's attempt to bring civil RICO claims against several out-of-state on-line retailers that did not file Jenkins Act reports.

Long Island reservation for violation of CCTA), *certifying questions to* Nos. 09-3942-CV (L), 09-3997-CV (CON), 2010 WL 724707 (2d Cir. Mar. 4, 2010) (certifying questions to New York Court of Appeals whether New York tax law in fact imposes tax on on-reservation sales when some of the cigarettes might be sold to individuals other than members of the reservation's nation or tribe); MATTHEW MYERS, CAMPAIGN FOR TOBACCO-FREE KIDS, FEDERAL COURT ORDERS LONG ISLAND, N.Y. TRIBAL SMOKE SHOPS TO STOP SELLING UNTAXED CIGARETTES TO GENERAL PUBLIC, Aug. 27, 2009, <http://www.prnewswire.com/news-releases/federal-court-orders-long-island-ny-tribal-smoke-shops-to-stop-selling-untaxed-cigarettes-to-general-public-62086732.html> (noting that New York's successful attempt to obtain an injunction is the first of its kind). But note that the City has accused the retailers of continuing to sell in violation of the injunction. *City: Indian Reservation Cigarettes Still Sold Untaxed*, CRAIN'S N.Y. BUS., Dec. 10, 2009, available at <http://www.crainsnewyork.com/article/20091210/FREE/912109987>.

⁹¹ See *supra* note 90 (providing examples of New York City suits).

⁹² *City of New York v. Smoke-Spirits.com*, 541 F.3d 425, 433 (2d Cir. 2008), *rev'd sub nom.* *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010).

⁹³ *Id.* at 425.

RICO authorizes a federal cause of action for treble damages by those showing (1) defendant's violation of RICO, and (2) an injury to their business or property (3) proximately caused by the defendant's violation.⁹⁴ The City alleged violation of RICO through § 1962(c), which required the City to prove the defendant's "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity."⁹⁵ A pattern of racketeering activity is defined as consisting of at least two enumerated predicate crimes.⁹⁶ Mail fraud is among the predicate crimes enumerated.⁹⁷

The City sued the retailers under several theories: civil RICO, common law fraud, common law public nuisance, and violation of New York's consumer protection statute.⁹⁸ The district court consolidated the suits and then dismissed all claims.⁹⁹ With respect to the state law claims, the Second Circuit approved the dismissal of the common law fraud claims but certified the remaining state law claims to the New York Court of Appeals,¹⁰⁰ which held that the claims could not proceed.¹⁰¹ With respect to the civil RICO claims, the Second Circuit reversed the dismissal in part, allowing the City's suit to proceed. However, defendant Hemi Group obtained certiorari, and the Supreme Court reversed, holding the RICO claims were barred.¹⁰²

The City had alleged that defendants' facilitation of evasion of tobacco taxes constituted a pattern of racketeering

⁹⁴ *Id.* at 440 n.19; *see also* 18 U.S.C. § 1964(c) (civil RICO provision).

⁹⁵ *Smoke-Spirits.com*, 541 F.3d at 439 (quoting *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 (1985)).

⁹⁶ 18 U.S.C. § 1961(5).

⁹⁷ 18 U.S.C. § 1961(1). Wire fraud and violations of the CCTA are also RICO predicates.

⁹⁸ *Smoke-Spirits.com*, 541 F.3d at 432. The consumer protection claims were under N.Y. GEN. BUS. § 349, which covers deceptive acts and practices. *Id.*

⁹⁹ Petition for Writ of Certiorari at *2-3, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), 2009 WL 245090.

¹⁰⁰ *Id.* at *3-4.

¹⁰¹ *City of New York v. Smoke-Spirits.com, Inc.*, 911 N.E.2d 834, 836 (N.Y. 2009).

¹⁰² *Hemi Group v. City of New York*, 130 S. Ct. 983, 985 (2010).

activity through mail fraud.¹⁰³ Federal mail fraud in this instance constituted (1) a scheme to defraud a victim (2) of property (3) through use of the mail.¹⁰⁴ The City alleged that, in addition to failing to file Jenkins Act reports, each of the defendants failed to inform customers of their obligation to pay city tax.¹⁰⁵ In fact, one group of defendants, including Hemi Group, advertised cigarettes as tax-free and represented that sales data would be kept private.¹⁰⁶ The City argued that both the failure to file Jenkins Act reports and the representations regarding customer tax obligations were schemes to defraud the City of tax revenues that entitled it to treble damages under RICO.¹⁰⁷ The Supreme Court considered (1) whether the Internet retailer's actions were the proximate cause of the injury and (2) whether lost tax revenues qualified as an injury to business or property for purposes of RICO.

1. Proximate Cause

With respect to the proximate cause issue, actionable conduct under RICO must be not only the cause-in-fact of the plaintiff's injury but also the proximate cause.¹⁰⁸ Proximate

¹⁰³ *City of New York v. Smoke-Spirits.com*, 541 F.3d 425, 433 (2d Cir. 2008), *rev'd sub nom.* *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010).

¹⁰⁴ *Id.* at 445; *see also* 18 U.S.C. § 1341 (2008) (The federal mail fraud statute, providing that "[w]hoever, having devised or intending to devise any scheme or artifice to defraud . . . for the purpose of executing such scheme or artifice or attempting so to do . . . deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier . . . shall be fined under this title or imprisoned not more than 20 years, or both.").

¹⁰⁵ *Smoke-Spirits.com*, 541 F.3d at 434.

¹⁰⁶ *Id.* These defendants were originally parties to the case captioned *City of New York v. Nexicon*, No. 03 CV 383 (DAB), 2006 U.S. Dist. LEXIS 10295 (S.D.N.Y. Mar. 15, 2006), *aff'd in part, vacated in part sub nom.* *City of New York v. Smoke-Spirits.com*, 541 F.3d 425, 433 (2d Cir. 2008), *rev'd sub nom.* *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010).

¹⁰⁷ Brief in Opposition to Petition at *1–2, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), 2009 WL 934105.

¹⁰⁸ *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 268 (1992).

cause demands a direct relationship between the defendant's conduct and the plaintiff's injury.¹⁰⁹ Hemi Group argued that the direct cause of the City's harm was the failure of customers to make their required tax payments.¹¹⁰ Additionally, because the Jenkins Act requires reporting to the State and not the City, Hemi Group argued that its actions were a further step removed from the harm.¹¹¹ In reply, the City claimed that the relationship was direct because Hemi Group's business model constituted a scheme to defraud the City of tax revenues that would flow directly into the pockets of Hemi Group and its customers.¹¹² The City argued that the mere fact that the State was also a victim did not make the fraudulent relationship any less direct.¹¹³

The Supreme Court held that the City could not show proximate cause for a civil RICO claim.¹¹⁴ The Court declined to opine on whether the State, which has a right to receive the reports directly, would have standing to bring a civil RICO claim.¹¹⁵ The Court concluded that the City could not show sufficient directness of injury because of the "general tendency" not to look beyond the first step in assessing directness of injury.¹¹⁶ The Court described the

¹⁰⁹ *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 457 (2006).

¹¹⁰ Petition for a Writ of Certiorari at *11–12, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), 2009 WL 245090.

¹¹¹ *Id.* Hemi Group argued that a state might choose not to share its Jenkins Act reports because it values "the privacy of proprietary business records" or because it does not want to intrude into interstate commerce. *Id.* at *13 n.4.

¹¹² See Brief in Opposition to Petition at *19, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), 2009 WL 934105.

¹¹³ *Id.*

¹¹⁴ *Hemi Group v. City of New York*, 130 S. Ct. 983, 990 (2010). The dissent would have found sufficient proximate cause based on a foreseeability, rather than a directness standard. *Id.* at 991 (Breyer, J., dissenting).

¹¹⁵ *Id.* at 990 ("The State certainly is better situated than the City to seek recovery We do not opine on whether the State could bring a RICO action.").

¹¹⁶ *Id.* at 989.

relationship between the City's harm and the alleged injurious conduct as even less direct than in *Anza v. Ideal Steel Supply Corp.*, where the relationship between a steel supplier's failure to pay sales tax and the harm to its competitor caused by competitive disadvantage was too indirect to support a civil RICO claim.¹¹⁷ In *Anza*, the same company both allegedly engaged in fraud and failed to pay taxes, while in *Hemi Group* the alleged fraud and failure to pay were attributable to different parties.¹¹⁸ Finding this conduct less direct than in *Anza*, the Court rejected the City's claims.¹¹⁹

2. Injury to Business or Property

The Court did not resolve the issue of whether lost tax revenue constitutes injury to business or property under RICO, but a court would face this question again were a state to bring a civil RICO claim. Injury to business or property is a necessary element of standing for a civil RICO claim.¹²⁰ Circuit courts have split in cases where a state or local government sued regarding injury to its property outside of contexts in which the government had been party to a commercial transaction.¹²¹ However, courts have held that such a deprivation of property is sufficient for a finding of mail fraud.¹²² Hemi Group argued that in enacting RICO Congress had taken the "business or property" requirement from language in the antitrust laws.¹²³ The Court had

¹¹⁷ *Id.* at 990 (citing *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 458 (2006)).

¹¹⁸ *See id.*

¹¹⁹ *Id.*

¹²⁰ 18 U.S.C. § 1964(c).

¹²¹ *See* Brief in Opposition to Petition at *12, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), 2009 WL 934105.

¹²² *See, e.g., United States v. Brewer*, 528 F.2d 492, 494 (4th Cir. 1975) (upholding mail fraud conviction for willful failure to comply with the Jenkins Act).

¹²³ Petitioners' Reply Brief at *8, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), 2009 WL 3368689. Specifically, § 7 of the Sherman Act and § 4 of the Clayton Act. *See id.*

previously held in *Hawaii v. Standard Oil Co.* that damage to the general economy of a state was not injury to property for purposes of the antitrust laws.¹²⁴

The City argued that *Standard Oil* depended on the indirectness of the connection between an antitrust violation and its injury to the property of a state but not on the state's position as a government entity.¹²⁵ The City relied on *Pasquantino v. United States*, in which the Court held that Canada's opportunity to collect taxes on whiskey was property for purposes of determining deprivation of property under the wire fraud statute.¹²⁶ The City argued further that when Congress amended RICO to include the CCTA as a predicate crime it must have intended for evasion of tobacco taxes to be an injury to property under the statute. Of course, the City did not sue based on the CCTA, and Congress might have intended to add the CCTA as a predicate for criminal actions without expecting it to expand the scope of civil liability by redefining property under the statute.¹²⁷

Because the Supreme Court concluded that the City could not establish proximate cause, it declined to address the question of injury to business or property.¹²⁸

¹²⁴ *Hawaii v. Standard Oil Co.*, 405 U.S. 251, 252 (1972).

¹²⁵ See Transcript of Oral Argument at 34, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), available at http://www.supremecourt.us/oral_arguments/argument_transcripts/08-969.pdf.

¹²⁶ Transcript of Oral Argument at 26, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969) (citing *Pasquantino v. United States*, 544 U.S. 349 (2005)), available at http://www.supremecourt.us/oral_arguments/argument_transcripts/08-969.pdf. Defendants in *Pasquantino* were convicted of wire fraud for a scheme to smuggle liquor into Canada to avoid Canadian excise taxes. 544 U.S. at 352.

¹²⁷ Compare 18 U.S.C. §§ 1961, 1962(c) with 18 U.S.C. § 1964(c). At the time of the alleged conduct, the CCTA did not yet apply to evasion of city tobacco taxes. Stohr, *supra* note 75 (statute was amended to cover localities in 2006).

¹²⁸ *Hemi Group v. City of New York*, 130 S. Ct. 983, 988 (2010).

B. Effects

1. Civil RICO Suits

Without being able to show proximate cause, localities will not be able to maintain future civil RICO suits against Internet retailers unless federal law is modified.¹²⁹ Bringing civil RICO suits using the CCTA as the predicate theory would not circumvent the problem because the CCTA covers the same conduct and therefore does nothing to reduce the degree of attenuation between the failure to file Jenkins Act reports and tax losses. It should still be possible to bring civil RICO suits against tribal parties selling, within the state, untaxed cigarettes directly to non-tribal members, but demonstrating the volume of sales to non-tribal members to establish damages could prove challenging.¹³⁰ Cities in

¹²⁹ Modifying federal law to require direct collection of taxes by Internet retailers should be sufficient. To the extent that courts would be willing to accept civil RICO suits by states, amending the Jenkins Act to require reports for the benefit of cities and localities would also suffice. Modifying RICO could also theoretically accomplish such a result.

¹³⁰ However, establishing the damages would be no more challenging when the sales are via the Internet to in-state purchasers. A substantial portion of domestic Internet vendors are based on New York reservations. See Kurt Ribisl et al., *Web Sites Selling Cigarettes: How Many Are There in the USA and What Are Their Sales Practices?*, 10 TOBACCO CONTROL 352, 352 (2001) (observing that 39 of 88 domestic Internet cigarette vendors in 2001 were located on Native American reservations in New York); Chen, *supra* note 8 ("As of 2005, nearly two-thirds of websites had some apparent affiliation with Indian reservations. For western New York's Seneca Nation, in particular, the online business has developed into the tribe's cash cow. Together, two Seneca reservations accounted for over three-quarters of all Indian websites in 2005."). Therefore, their sales to New York customers presumably would be subject to civil RICO suit because they would be responsible for collecting the tax directly. Any such suits could use either the CCTA or mail/wire fraud as the RICO predicates. While the CCTA's civil provision does not authorize suits against tribal members on tribal property, 18 U.S.C. § 2346(b)(1), tribe members are not exempt from criminal violation of the CCTA. See *United States v. Baker*, 63 F.3d 1478, 1484 (9th Cir. 1995), *cert. denied* 516 U.S. 1097 (1996) (affirming CCTA convictions based on sales of unstamped cigarettes to reservations).

particular would face the added burden of showing the untaxed sales proximately caused them tax losses when the sales were not even subject to city taxes.¹³¹ Where tribes themselves make the sales, tribal sovereignty would impose another hurdle.¹³²

Though the Court declined to consider whether a state might be able to bring a civil RICO claim, even were states to succeed in bringing such claims they are not a solution to the state and local tax evasion problem. As a threshold matter, defendants could argue that their actions do not constitute mail or wire fraud in light of *Hemi Group*. For its analysis, the Court assumed the failure to file Jenkins Act reports constituted mail fraud because Hemi Group did not object.¹³³ However, in a footnote, the Court suggested that the willful failure to file Jenkins Act reports was not intended to defraud the City of taxes but to sell more cigarettes.¹³⁴ While mail fraud prosecutions have been maintained for such conduct in the past, defendants might argue that this footnote shows the Court's desire to foreclose such charges in

¹³¹ See *United States v. Morrison*, No. 04-CR-699 (DRH)(S-2), 2010 WL 480866, at *6 (E.D.N.Y. Feb. 12, 2010) (denying restitution to New York City for on-reservation sales in violation of the CCTA because the City's harm was too indirect), *vacated on other grounds* N.Y.L.J., Apr. 20, 2010, at 17 (Apr. 16, 2010).

¹³² See *Oklahoma Tax Comm'n v. Citizen Band of Potawatomi Tribe*, 498 U.S. 505, 509 (1991) (citing *Santa Clara Pueblo v. Martinez*, 436 U.S. 49, 58 (1978)) ("Suits against Indian tribes are thus barred by sovereign immunity absent a clear waiver by the tribe or congressional abrogation.").

¹³³ *Hemi Group*, 130 S. Ct. at 988.

¹³⁴ *Id.* at 991 n.1 ("Hemi's aim was not to defraud the City (or the State, for that matter) of tax revenue, but to sell more cigarettes. . . . Hemi's alleged fraud was aimed at Hemi's competitors, not the City."). In her concurrence, Justice Ginsburg argued that Hemi Group had engaged in fraud "only insofar as it violated the Jenkins Act." *Id.* at 995 (Ginsburg, J., concurring). Any fraud to competitors via a scheme to avoid taxes is not actionable under *Anza*. *Id.* Note that the Court did not consider the defendants' statements to taxpayers that the cigarettes were tax free as a basis for fraudulent predicate acts because such an argument was not made in the District Court. *Id.* at 994.

the future.¹³⁵ Ordinarily, specific intent for mail fraud is proven by demonstrating the existence of a scheme reasonably calculated to deceive persons of ordinary prudence, based on examining the scheme itself.¹³⁶ Business plans based on smuggling to evade taxes have been held to constitute schemes to defraud, and there is no reason to suspect that tax evasion over the Internet would be treated differently.¹³⁷ In any case, the Court's holding in *Hemi Group* was limited to proximate cause, and while a lack of proximate cause may limit the application of civil RICO, it probably will not prevent application of the mail and wire fraud statutes to the conduct.

Defendants who make active misrepresentations regarding cigarettes being tax-free, like those in *Hemi Group*, could also be argued to have committed fraud directly through their misrepresentations.¹³⁸ The Court in *Hemi*

¹³⁵ See *United States v. Brewer*, 528 F.2d 492, 494 (4th Cir. 1975) (prior prosecution for mail fraud for failure to file Jenkins Act reports).

¹³⁶ *United States v. Green*, 745 F.2d 1205, 1207 (9th Cir. 1984).

¹³⁷ See *Pasquantino v. United States*, 544 U.S. 349, 375 (2005) (intent to violate Canadian tax law); *United States v. Trapilo*, 130 F.3d 547, 550 n.2 (2d Cir. 1997) (quoting *United States v. Von Barta*, 635 F.2d 999, 1005 n.12 (2d Cir. 1980)) ("The term 'scheme to defraud' is measured by a 'nontechnical standard. It is a reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general [and] business life of members of society.'").

¹³⁸ Brief in Opposition to Petition at *1-2, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), 2009 WL 934105. The City of New York represented at oral argument that Hemi Group's misrepresentations were part of the theory of the case: "He is the one who created the fraud, by leading the consumer to believe they didn't have an obligation to pay. We are suing based on impudence with the opportunity to collect taxes." Transcript of Oral Argument at 36, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), available at http://www.supremecourtus.gov/oral_arguments/argument_transcripts/08-969.pdf. The City admitted that it would have to prove that the misrepresentations in fact caused a failure to pay taxes. *Id.* at 35-36. Note, however, that a court might not find representations necessary based on a failure to disclose theory. The defendant in *Brewer* was convicted of mail fraud without evidence of having advertised cigarettes as tax free. *United States v. Brewer*, 528 F.2d 492, 494 (4th Cir. 1975). The court noted that she had sold cigarettes through the mail at a price

Group did not consider whether these misrepresentations could constitute predicate acts for civil RICO because they were not pled in the District Court.¹³⁹ To be actionable under mail fraud, misrepresentations must be either (1) objectively reliable or (2) such that the defendant should have known the victim would regard them as important.¹⁴⁰ To the extent such misrepresentations were to be held actionable, retailers could try to structure their representations to the tax status of their cigarettes such that they do not appear reliable or do not mislead with respect to tax obligations, thus weakening the strength of the mail fraud claims against them.¹⁴¹

Additionally, bringing a civil RICO suit requires proof that the tax evasion scheme was willful.¹⁴² Courts would want to take care in interpreting this requirement, lest they create doctrine that would allow states to bring civil RICO suits against any Internet retailer who fails to collect sales taxes that are due.¹⁴³ While, before *Hemi Group*, retailers

substantially lower than the cost with taxes, *id.*, although a defendant presumably could argue that doing so is reasonable, given that the taxes are to be paid by the consumer. Courts would probably consider the willful failure to make the necessary disclosures sufficient for a scheme to defraud. *See, e.g.,* Pasquantino v. United States, 544 U.S. 349, 355 (2005).

¹³⁹ *Hemi Group v. City of New York*, 130 S. Ct. 983, 985 (2010).

¹⁴⁰ *See* United States v. Svete, 556 F.3d 1157, 1162–66 (11th Cir. 2009) (en banc).

¹⁴¹ For example, www.smokes-spirits.com now does not make representations regarding purchasers' tax obligations. *See* Smokes-Spirits.com Frequently Asked Questions, <http://www.smokes-spirits.com/FAQ%27s.aspx/store/0#18> (last visited Mar. 1, 2010) (“[Q] Will I be charged taxes? [A] We are a Native American business located on the Seneca Nation (a Sovereign Nation) in Western New York. It is the responsibility of the Buyer to ascertain and comply with any laws in regard to the purchase and use of any cigarette products. In order to determine the applicable limits on purchases or taxing responsibilities, if any, imposed by your particular state, the consumer may want to contact their state authorities.”). The site's privacy policy states that customer information will not be disclosed “to anyone for any reason.” *Id.*

¹⁴² *See* United States v. Brewer, 528 F.2d 492, 496 (4th Cir. 1975).

¹⁴³ *See* Zelinsky, *supra* note 81, at 18–19 (explaining how an Internet retailer can face difficulties determining whether it is in a position where it must collect sales tax on shipments to the state); *cf.* Transcript of Oral Argument at 42, *Hemi Group v. City of New York*, 130 S. Ct. 983 (2010)

took little caution to hide their satisfaction of this element, retailers seeking to avoid suit can complicate proof by, for example, insisting they were not notified of Jenkins Act requirements or that they believed the Act did not apply to them, or else by filing false, infrequent, or periodic reports to create evidence of attempts at compliance.¹⁴⁴ Further, civil RICO suits require proof of a racketeering enterprise, so the tactic will be difficult to apply against lone individuals selling untaxed cigarettes on-line.¹⁴⁵

2. Federal Alternatives to RICO

Even without civil RICO suits, Internet retailers still might face the threat of criminal conviction. The CCTA's reach may be broad enough to cover willful repeated failures to file Jenkins Act reports.¹⁴⁶ Assuming courts do not treat

(No. 08-969) (Ginsburg, J.) ("Why is what [Hemi Group is] doing any different from what out-of-State mail order houses have done in—they set—they set up in States without a sales tax, they ship into a State that has a compensating use tax, that, apart from automobiles, I don't know is ever collected."), *available at* http://www.supremecourtus.gov/oral_arguments/argument_transcripts/08-969.pdf.

¹⁴⁴ For example, some native retailers argue that their tribal sovereignty or treaties exempt them from the reporting requirements, *see* GAO 2002 REPORT, *supra* note 24, at 17, and at least one retailer informed the GAO it believed the Internet Tax Freedom Act exempted it from filing the reports, *id.* at 18.

¹⁴⁵ *See* City of New York v. Smoke-Spirits.com, 541 F.3d 425, 435 n.15 (2d Cir. 2008), *rev'd sub nom.* Hemi Group v. City of New York, 130 S. Ct. 983 (2010) (citing Cedric Kushner Promotions, Ltd. v. King, 533 U.S. 158, 161 (2001) (noting that a civil RICO suit must allege and prove the existence of both a person and an entity that is not simply the person by another name)). The legal distinction between a person and a corporation owned by that person is sufficient, however, *Cedric Kushner*, 533 U.S. at 166, provided that the corporation is not "a one-man show." *McCullough v. Suter*, 757 F.2d 142, 144 (7th Cir. 1985).

¹⁴⁶ *See* City of New York v. Golden Feather Smoke Shop Inc., No. 08-CV-3966, 2009 WL 2612345, at *1 (E.D.N.Y. Aug. 25, 2009) (New York City obtained preliminary injunction against sellers for violation of CCTA), *certifying questions to* Nos. 09-3942-CV (L), 09-3997-CV (CON), 2010 WL 724707 (2d Cir. Mar. 4, 2010); 18 U.S.C. § 2346(b)(2) (2006). The statute prohibits "any person knowingly to ship [or] . . . sell" more than 10,000 cigarettes "which bear no evidence of the payment of applicable

Hemi Group as foreclosing prosecutions for mail or wire fraud, such charges could be brought as they were in the past.¹⁴⁷ The mail and wire fraud statutes do not have a proximate cause requirement.¹⁴⁸ The Jenkins Act reports are presumably property in the hands of the state sufficient to invoke the mail and wire fraud laws.¹⁴⁹ While the Supreme Court has recognized limits on the scope of property for mail and wire fraud, the opportunity to collect taxes via the reports is even more concrete than the Canadian

State or local cigarette taxes in the State or locality where such cigarettes are found.” 18 U.S.C. § 2341(2); 18 U.S.C. § 2342(a) (2006). The City of New York indicated it would seek to use the CCTA after *Hemi Group*. Stohr, *supra* note 75. The ATF also appears to believe Internet retailers can be liable under the CCTA in some cases even if they file Jenkins Act reports. See U.S. GEN. ACCOUNTING OFFICE, INTERNET CIGARETTE SALES: LIMITED COMPLIANCE AND ENFORCEMENT OF THE JENKINS ACT RESULTS IN LOSS OF STATE TAX REVENUE 6 (2003), available at <http://www.gao.gov/new.items/d03714t.pdf> (“Internet cigarette vendors that violate the CCTA, either directly or by aiding and abetting others, can also be charged with violating the Jenkins Act if they failed to comply with the act’s reporting requirements.”). In *Milhelm*, the city was able to bring suit under the CCTA against a wholesaler selling unstamped cigarettes to tribal entities who then resold the cigarettes untaxed, implying that the CCTA would likewise cover the conduct of an Internet retailer selling cigarettes to consumers who would then fail to pay the tax. *City of New York v. Milhelm Attea & Bros.*, 550 F. Supp. 2d 332, 336 (E.D.N.Y. 2008), modified No. 06-CV-3620 (CBA), 2009 U.S. Dist. LEXIS 19351 (E.D.N.Y. Mar. 11, 2009). One could attempt to distinguish *Milhelm* on the grounds that there the wholesaler had more specific knowledge of noncompliance than a typical Internet retailer would, but the willful failure to file required Jenkins Act reports indicates the retailers’ knowledge that tax would not be paid.

¹⁴⁷ *United States v. Brewer*, 528 F.2d 492, 494 (4th Cir. 1975) (mail fraud prosecution for failure to file Jenkins Act reports). See also *supra* text accompanying notes 133–37 (discussing mail/wire fraud issues for willful failure to file Jenkins Act reports after *Hemi Group*).

¹⁴⁸ See *United States v. Richman*, 944 F.2d 323, 332 (7th Cir. 1991) (“Neither the ultimate success of the fraud nor the actual defrauding of a victim is crucial to a successful prosecution.”).

¹⁴⁹ See *Pasquantino v. United States*, 544 U.S. 349, 355 (2005) (holding that failure to disclose liquor shipments deprived Canada of its property interest in the collection of excise taxes for purposes of wire fraud).

government's opportunity in *Pasquantino*.¹⁵⁰ Further, Internet retailers could be found liable for mail fraud or CCTA violations based on the theory that they caused their customers' failure to pay taxes.¹⁵¹

Additionally, civil causes of action alternative to RICO remain, though without the possibility of treble damages. While civil CCTA suits for damages have not been brought, the statute authorizes states to obtain damages, and its reach may be broad enough to cover Internet retailers.¹⁵² Such an approach would not work against tribal entities.¹⁵³

States could also try to bring civil suits based on implied standing under the Jenkins Act. In *Washington Department of Revenue v. www.dirtcheapcig.com, Inc.*, the State of Washington was able to bring a civil action based on an

¹⁵⁰ See *id.* at 357; *Cleveland v. United States*, 531 U.S. 12, 20 (2000) (holding that for purposes of mail/wire fraud Louisiana does not part with "property" when it issues a video poker license). Unlike in *Cleveland*, the Jenkins Act reports do not exist to implement a regulatory scheme but to allow the government to collect money. Cf. *United States v. 1,920,000 Cigarettes*, No. 02-CV-437A, 2003 U.S. Dist. LEXIS 12603, at *16-17 (W.D.N.Y. Mar. 31, 2003) (distinguishing *Cleveland* with respect to government's right to collect cigarette taxes). Thus, just as in *Pasquantino*, the reports are property in the sense that they are tangible documents containing information the state can use to obtain money. Cf. *Carpenter v. United States*, 484 U.S. 19, 25 (1987) (unanimously upholding wire fraud conviction on the grounds that intangible information can still be property for purposes of mail or wire fraud).

¹⁵¹ See *United States v. Sabo*, No. 2:07-cr-0081-RLH-PAL, 2008 WL 4361054, at *3-4 (D. Nev. Sept. 24, 2008) (citing *United States v. Causey*, 835 F.2d 1289, 1291 (9th Cir. 1987)) (holding a person can be liable under 18 U.S.C. § 2(b) "even though the person who completed the wrongful act violates no criminal statute because of lack of criminal intent or capacity").

¹⁵² See *supra* note 146 and accompanying text.

¹⁵³ See 18 U.S.C. § 2346(b)(1) (2006). Any state application of the statute against tribes could face difficulties in overcoming tribal sovereignty defenses. See, e.g., *Grey Poplars, Inc. v. One Million Three Hundred Seventy One Thousand One Hundred (1,371,000) Assorted Brands of Cigarettes*, 282 F.3d 1175, 1177 (9th Cir. 2002) (noting that a state's abilities against a tribe under the CCTA could be different than federal abilities).

implied cause of action under the Jenkins Act.¹⁵⁴ However, the reasoning of *Dirtcheapcig.com* may not be followed by other courts.¹⁵⁵ In determining whether a federal statute implies a private right of action, courts consider whether: (1) the plaintiff is of a class for whose special benefit the statute was enacted; (2) there is indication of legislative intent to imply or deny private right of action; (3) implying the right of action is consistent with the purposes of the legislative scheme; and (4) the cause of action is an area traditionally under state law and of state concern, such that inferring a federal cause of action would be inappropriate.¹⁵⁶

The court in *Dirtcheapcig.com* found an implied private right of action in the Jenkins Act, relying on the fact that the Act empowers district courts to restrain violations in concluding that Congress did not intend the Act to be solely a criminal statute.¹⁵⁷ The court concluded that all four factors weighed in favor of an implied right but particularly the first (class with special benefit) and third (consistent with scheme).¹⁵⁸ It is not at all clear that other courts would follow this analysis. The Supreme Court has become less willing to accept implied private rights of action,¹⁵⁹ focusing

¹⁵⁴ 260 F. Supp. 2d 1048, 1055 (W.D. Wash. 2003) [hereinafter *Dirtcheapcig.com*].

¹⁵⁵ See, e.g., *City of New York v. Cyco.net, Inc.*, 383 F. Supp. 2d 526, 551 n.11 (S.D.N.Y. 2005) ("It is extremely unlikely that any party other than the federal government may sue under the Jenkins Act. Despite a conclusory holding in . . . *Angelica Co. v. Goodman*, 52 Misc. 2d 844, 276 N.Y.S.2d 766, 767, which stated that '[t]he city as well as the State has the power to enforce an act such as the Jenkins Act,' and the reasoning of *State of Washington Dept. of Revenue v. www.dirtcheapcig.com, Inc.*, 260 F. Supp. 2d 1048, 1055 n.2 (W.D. Wash. 2003) . . . this Court remains unconvinced that parties other than the federal government may sue under the Jenkins Act.").

¹⁵⁶ *Cort v. Ash*, 422 U.S. 66, 78 (1975), as construed in *Touche, Ross, & Co. v. Redington*, 442 U.S. 560, 575–76 (1979).

¹⁵⁷ *Dirtcheapcig.com*, 260 F. Supp. 2d at 1054–55; see 15 U.S.C. § 378 (authorizing district courts to restrain violations).

¹⁵⁸ *Dirtcheapcig.com*, 260 F. Supp. 2d at 1054–55.

¹⁵⁹ Susan J. Stabile, *The Role of Congressional Intent in Determining the Existence of Implied Private Rights of Action*, 71 NOTRE DAME L. REV. 861, 870–71 (1996) ("[R]ecent cases suggest that a private plaintiff has no

attention on the second factor, legislative intent, as determinative and tending to use the other factors only as indicia of legislative intent.¹⁶⁰ There is not strong evidence that Congress intended to create an implied right of action under the Jenkins Act.¹⁶¹ Indeed, that the Act is primarily a criminal statute requiring reporting to the federal government would normally weigh against finding an implied cause of action for private parties.¹⁶² In any event, cities and local governments would likely not have standing to bring claims under the Jenkins Act, as the statute was not even passed for their benefit.¹⁶³

Finally, whether damages are treble or not, they must be proven. Even when Jenkins Act reports are filed taxes remain difficult to collect; therefore, it will not be easy to prove that any failure to file the reports is the source of large damages. In *Hemi Group*, the City insisted that it was capable of proving its damages at trial.¹⁶⁴ However, a city or state would face difficulty in actually demonstrating this proof. Without Jenkins Act reports, the city or state would

cause of action unless the statute grants one or there is clear congressional intent to grant one.”); *See Alexander v. Sandoval*, 532 U.S. 275, 287 (2001) (“Having sworn off the habit of venturing beyond Congress’s intent [in finding implied private rights of action], we will not accept [the] invitation to have one last drink.”)

¹⁶⁰ *See Mutlu v. Jetblue Airways Corp.*, No. 08-CIV-4887 (LAP), 2009 U.S. Dist. LEXIS 60164, at *11–12 (S.D.N.Y. Mar. 31, 2009) (citing *Touche, Ross, & Co.*, 442 U.S. at 568, 575–76; *Thompson v. Thompson*, 484 U.S. 174, 189 (1988) (Scalia, J., concurring)).

¹⁶¹ *See Dirtcheapcig.com*, 260 F. Supp. 2d at 1054–55 (citing as evidence of legislative intent that Congress amended the act to ensure that venue for claims under the act would be in the district in which the state tax administrator is located).

¹⁶² *See City of New York v. Cyco.net, Inc.*, 383 F. Supp. 2d 526, 551 n.11 (S.D.N.Y. 2005) (expressing skepticism that a federal criminal act requiring the filing of reports would imply a private right of action).

¹⁶³ *Cf. Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (“The State certainly is better situated than the City to seek recovery We do not opine on whether the State could bring a RICO action . . .”).

¹⁶⁴ *See Transcript of Oral Argument at 35–36, Hemi Group v. City of New York*, 130 S. Ct. 983 (2010) (No. 08-969), available at http://www.supremecourtus.gov/oral_arguments/argument_transcripts/08-969.pdf.

not normally even be aware of sales. Once the city or state does become aware, it can mitigate damages by sending requests for payment to customers, who after all are the ones who owe tax.¹⁶⁵ To the extent they pay, no damages lie, and to the extent they do not, defendants will argue that the proximate cause is not the failure to file reports but instead the customer's recalcitrance. In that scenario, the city or state has the very information it would want from the Jenkins Act reports, so it cannot claim harm in lacking the reports themselves. Further, in places such as New York where a citizen can voluntarily submit use tax payments through a line on their income tax return, the state would also have to prove the individual did not in fact make payments.¹⁶⁶

In any event, the administrative costs of suit are high, and a city or state will likely not have a good sense of what type of damages they might be able to obtain until after they file suit and obtain discovery, since they have no apparent alternative source of sales data. If what the City really wanted was a means to burden Internet retailers with litigation risk by bringing a lawsuit that can pass a motion to dismiss, it already has some ability to do so via the CCTA (or possibly through an action based on implied standing under the Jenkins Act), as well as the possibility of obtaining an injunction.¹⁶⁷

¹⁶⁵ In fact, the city or state must actually provide a method for payment of these taxes to argue that defendants are responsible for the failure to pay. If the state or city do not even have a method for customers to remit payment, then the city or state itself could be argued to be a proximate cause of the failure.

¹⁶⁶ See, e.g., New York State 2008 Form IT-203, box 56. In New York this line does not require a description of the reason for the tax (e.g., purchase of cigarettes, purchase of on-line merchandise), so to the extent the customer actually paid tax in this manner the city or state would not know whether that tax was attributable to the tobacco purchases.

¹⁶⁷ See *supra* notes 146, 154.

IV. TOOLS TO COMBAT EVASION AFTER *HEMI GROUP*

A. Federal Resources

Schemes to evade state tobacco excise taxes remain serious federal crimes, either through the CCTA or mail or wire fraud. States can bring evidence of occurrences of such crimes to federal authorities.¹⁶⁸ However, federal criminal enforcement is of limited effectiveness as a solution to state problems. Federal policy and interest do not favor assisting states with tax collection.¹⁶⁹ For example, the Seneca Tribe has been described as a significant source of evasion, both via direct sales and over the Internet, and while the ATF has collaborated with the tribe to prevent illicit cigarette smuggling, it has yet to take any action regarding the tribes' refusal to cease selling untaxed cigarettes.¹⁷⁰ As previously discussed, federal resources for combating tobacco diversion

¹⁶⁸ While U.S. Attorney's offices might have in some instances been reluctant to prosecute Jenkins Act violations, *see supra* note 74 and accompanying text, the CCTA has been another matter and might apply to serious Jenkins Act violations in any case, *see supra* note 146. U.S. Attorneys might also be more amenable to such cases if they were presented as mail fraud cases. Finally, the ATF can bypass U.S. Attorneys to some extent by bringing its own forfeiture cases against the proceeds of illegal cigarette sales. *See, e.g.,* Cohen, *supra* note 30, at 7; Ashley L. Taylor, Jr. et al., Troutman Sanders, Federal Law Enforcement Agencies are Aggressively Enforcing State Tobacco Laws (June 12, 2009), <http://www.troutmansanders.com/federal-law-enforcement-agencies-are-aggressively-enforcing-state-tobacco-laws-06-12-2009/>.

¹⁶⁹ *See, e.g.,* Michigan Dep't of Treasury v. Fawaz, 848 F.2d 194, at *2 (6th Cir. 1988) (unpublished) ("[T]he [Michigan] attorney general is asking us to designate the district courts as collection agencies for unpaid state taxes, presumably because he can there pursue treble damages. This, in the interest of comity, we dare not permit . . . [H]is desire should be brought to the attention [of] Michigan's legislature.").

¹⁷⁰ Chen, *supra* note 8 (describing the Seneca as a source of evasion); *see* Zremski, *supra* note 44; Cohen, *supra* note 30, at 8 ("ATF has sought voluntary compliance from Seneca's . . . ATF working on [a] Test Case . . . [Seneca] increased cooperation with ATF and WDNV.").

are limited.¹⁷¹ The ATF is not equipped to battle tobacco diversion on a large scale in part because the federal government has diverted significant law enforcement resources towards terrorism.¹⁷² Terrorism has become the highest priority for the Department of Justice and FBI.¹⁷³

As a result, federal law enforcement authorities in other areas are stretched thin, and general increases in funding will not likely go to combating tobacco evasion.¹⁷⁴ However, some specific funding increases could be achieved. For example, proposed federal legislation would allocate \$8.5 million specifically to the ATF's tobacco interdiction efforts.¹⁷⁵ Such an appropriation would increase the ATF's tobacco budget by roughly half to about \$28.3 million.¹⁷⁶ However, states cannot rely on such measures to solve evasion problems. These resources are not aimed at Internet evasion, and smuggling investigations are so time consuming that federal enforcement can never be expected to eliminate smuggling problems. For example, ATF seizures from

¹⁷¹ See *supra* text accompanying note 83.

¹⁷² At the end of 2008, the ATF had 257 open investigations covering both alcohol and tobacco. OIG REPORT, *supra* note 2, at iii. Historically approximately twelve percent of such investigations related to alcohol. *Id.*

¹⁷³ See David Johnston & Neil Lewis, *White House to Keep Agencies' Focus on Terrorism*, N.Y. TIMES, Mar. 25, 2009, at A16, available at <http://www.nytimes.com/2009/03/26/us/politics/26justice.html?>

¹⁷⁴ See *id.* (FBI director Robert Mueller quoted as stating: "The logical consequence of cannibalizing our criminal program to augment our national security efforts is that we have reduced the ability to surge resources within our criminal branch."). Regarding the ATF, see *supra* note 83. FBI Director Mueller stated that the FBI wanted more funding to address financial crimes and narcotics trafficking. See Johnston & Lewis, *supra* note 173.

¹⁷⁵ See Prevent All Cigarette Trafficking Act of 2009 ("PACT Act"), H.R. 1676, 111th Cong. § 7(b) (as referred to Senate, June 1, 2009). This funding meets ATF's own request for additional funding in FY 2010 turned down by OMB. See OIG REPORT, *supra* note 2, at v. The ATF had requested that its diversion budget be raised from \$19.7 to \$28.3 million. *Id.*

¹⁷⁶ The OIG reports that the ATF's annual alcohol and tobacco diversion budget between FY 2004 and FY 2009 was approximately \$16.5 to 20 million. See OIG REPORT, *supra* note 2, at iii.

tobacco-smuggling cases in 2008 valued \$26.7 million on an investigation budget in the neighborhood of \$20 million.¹⁷⁷ Even with budget increases and efficiency gains, a \$5 billion evasion market is not within reach.¹⁷⁸ Further, since investigators usually pursue the most significant cases available to them, one might expect the marginal efficiency of additional investigators to be decreasing in some cases. Even in the best-case scenario, federal law enforcement could only be expected to combat large smuggling networks.¹⁷⁹ Opportunistic individuals and small groups will likely stay off the federal radar, although bringing federal prosecutions against Internet retail evaders under the CCTA or for mail fraud could have a deterrent effect, particularly in the short term.

In the long term, combating evasion problems through aggressive federal criminal enforcement is not ideal. The ratio of cost of enforcement to reduction in evasion is high, and criminal enforcement imposes additional social collateral costs, such as the cost of imprisonment. Further, federal law enforcement priorities tend to shift from administration to administration, so any commitment to enforcement initiatives that states attain may only be temporary.¹⁸⁰ Because state interest in effective enforcement is limited to states that are the targets, as opposed to the suppliers, of smuggled cigarettes, federal interest in enforcement will be

¹⁷⁷ See OIG REPORT, *supra* note 2, at iii, 16–17. Note that ATF seizures for the first quarter of 2009 dramatically increased, with \$25.6 million in seizures for that quarter alone. *Id.* at 17.

¹⁷⁸ See *supra* note 27.

¹⁷⁹ Although even that may not be achievable. Cf. NANCY E. MARION, A HISTORY OF FEDERAL CRIME CONTROL INITIATIVES, 1960–1993, at 243 (1994) (“It can be easily argued that the federal laws on organized crime are partly symbolic.”).

¹⁸⁰ See MARION, *supra* note 179, at 232 (“Presidential agenda setting often lacks a clear pattern or a sense of planning. . . . [E]ach President since John Kennedy has attempted to create an agenda for reducing crime in the United States.”); *id.* at 235 (“[T]he federal government is realistically limited as to the extent of possible involvement [in solving crime].”).

difficult to sustain.¹⁸¹ Likewise, federal law enforcement personnel do not have incentives to direct their resources to solve state budget problems, and they operate with enough autonomy that their long-term focus on smuggling cannot be anticipated.¹⁸²

States have looked to strengthened federal legislation as a solution to their enforcement problems.¹⁸³ Certainly, preventing the U.S. Postal Service from delivering illegal Internet sales would be beneficial and could significantly limit Internet sales in some states.¹⁸⁴ Similarly, Jenkins Act reports could be more effective if required to be filed in a specific format with the federal government, which can then be accessed by state and local governments.¹⁸⁵ Further

¹⁸¹ Cf. Michael M. O'Hear, *Federalism and Drug Control*, 57 VAND. L. REV. 783, 844–46 (2004) (describing how geographic heterogeneity of political interest in narcotics enforcement provides Congress with incentives to offer some federal assistance but not to take responsibility for enforcement).

¹⁸² Cf. William J. Stuntz, *The Pathological Politics of Criminal Law*, 100 MICH. L. REV. 505, 542–45 (2001) (analyzing the incentives of federal prosecutors and arguing that they pursue an agenda “consistent with the pursuit of professional advancement”).

¹⁸³ See, e.g., *Prevent All Cigarette Trafficking Act (PACT Act) of 2003*, 108th Cong. (2003) (statement of Sen. Orrin Hatch, Chairman, S. Judiciary Comm.), available at http://hatch.senate.gov/newsite/index.cfm?FuseAction=PressReleases.Print&PressRelease_id=207122&suppresslayouts=true (citing requests to strengthen state tools through federal legislation); Ashley L. Taylor, Jr., Troutman Sanders, *Hemi Group Decision Will Reshape Cigarette Marketing Laws* (Jan. 29, 2010), <http://www.troutmansanders.com/hemi-group-decision-will-reshape-cigarette-marketing-laws-01-29-2010/> (“The Court’s decision in *Hemi Group* will most likely result in additional pressure for Congress to enact the PACT Act or to expand the Jenkins Act to give cities and states more tools to enforce tax obligations against tobacco companies.”).

¹⁸⁴ Such a provision would be included in the Prevent All Cigarette Trafficking Act of 2009 (“PACT Act”), H.R. 1676, 111th Cong. § 3(a) (as referred to Senate, June 1, 2009). Preventing the postal service from shipping cigarettes would make it practically impossible to make large-scale Internet sales into states that have reached agreement with private carriers to not ship tobacco products.

¹⁸⁵ In this manner local governments could have a right of access to the reports, instead of having to negotiate with their state governments.

statutory change could provide a clear civil cause of action for states to use against Internet retailers that do not file Jenkins Act reports.¹⁸⁶ However, states can already bring civil actions under the CCTA and possibly even under the Jenkins Act; as such, empowering a state to bring a civil action to enjoin behavior that is already chargeable as a federal felony is not likely to increase deterrence.¹⁸⁷ Individual civil actions are also quite limited as a tool. Individual civil suits against Internet retailers may change the way retailers do business but will probably not actually shut them down. Since the costs of shutting down a website and starting up a new one are sufficiently low in relation to the potential profits, suing each retailer individually is not likely to solve the problem, even with effective civil causes of action.¹⁸⁸

Such an approach would also lessen the difficulty a state faces when it cannot determine if a manufacturer is not filing Jenkins Act reports in general or just did not have any sales in that specific state, since the state could look in the federal data to see whether reports were filed for other states. Of course, a retailer might omit filing Jenkins Act reports in some states and not others, particularly if states are heterogeneous in the extent to which they follow up on Jenkins Act reports with customers.

¹⁸⁶ See Prevent All Cigarette Trafficking Act of 2009 ("PACT Act"), H.R. 1676, 111th Cong. § 4(c)(1)(A) (as referred to Senate, June 1, 2009). Note that the proposed act would not abrogate the sovereign immunity of tribes. See *id.* at § 4(c)(1)(B).

¹⁸⁷ Cf. OIG REPORT, *supra* note 2, at 16 (describing how even existing CCTA criminal penalties are not sufficient to fully deter smuggling). But note that such legislation would be needed to allow localities to bring suits under the Jenkins Act, as they are not currently a part of the class for whose benefit the statute was enacted. Localities are covered by the CCTA. See Stohr, *supra* note 75.

¹⁸⁸ See ERIC LINDBLOM, CAMPAIGN FOR TOBACCO-FREE KIDS, THE CRITICAL IMPORTANCE OF A DELIVERY-LIST ENFORCEMENT PROVISION IN STATE INTERNET TOBACCO SALES LEGISLATION 1 (2005), <http://www.tobaccofreekids.org/research/factsheets/pdf/0259.pdf> ("[I]llegal Internet sellers faced with enforcement lawsuits could easily close up shop and quickly reappear with another name and website address. It is also often extremely difficult (and expensive) for state enforcement officials to reach illegal Internet sellers based overseas, in distant states, or in other protected jurisdictions.").

B. State Resources

1. Internet Evasion

Even to the extent legal techniques are effective at causing Jenkins Act compliance, forcing retailers to file reports can only accomplish so much. States must still track down customers and extract taxes from them.¹⁸⁹ Moreover, states have faced problems in convincing customers to pay sales tax on Internet sales that will remain unaddressed.¹⁹⁰ When Internet sales are allowed, the collection of taxes on those sales is part of a larger tax evasion battle.¹⁹¹ Some states have tried to address the problem by adopting aggressive legislation imposing tax obligations on a broader set of Internet retailers, while others have focused on trying to encourage businesses to cooperate with tax collection.¹⁹² As matters stand, any success in forcing Internet retailers to collect use taxes would impose a significant technological burden, based on how many taxing jurisdictions there are.¹⁹³ An effective federal solution to the larger problem of use taxes would of course aid the states in combating Internet evasion, but is not imminently likely.¹⁹⁴

¹⁸⁹ See *supra* text accompanying notes 71–72; LINDBLOM, *supra* note 76, at 3–4.

¹⁹⁰ Although unlike with retail sales tax, states would have a list of those purchasing goods. Still, when those individuals do not pay the tax, states do not have powerful evidence that the individual in fact bought cigarettes, since the Jenkins Act reports are not conclusive proof.

¹⁹¹ See Sales Tax Fairness Simplification Act, *supra* note 80.

¹⁹² See John Buhl, *New York, California Nexus Rules Undermine Streamlining, Panelists Say*, 48 STATE TAX NOTES MAG. 345 (2008) (describing New York and California's efforts to overturn *Quill*); Laura Kennedy, *Other States May Copy New York's Amazon Tax Law*, KIPLINGER, May 13, 2008, available at http://www.kiplinger.com/business/resource/forecast/archive/Copying_New_York_Amazon_Law_080513.html.

¹⁹³ See Kennedy, *supra* note 192 ("Taxing online sales will require retailers to install complex collection systems to monitor the more than 7,400 tax jurisdictions nationwide.").

¹⁹⁴ See, e.g., *Political and Economic Climate Improving for Streamlined Sales Tax Project*, ACCOUNTING WEB, June 18, 2009,

States could try to address this problem before a federal solution by imposing a tax directly on Internet retailers and then arguing that courts should restrain themselves in applying *Quill* and the dormant Commerce Clause. Such an approach, however, is speculative, and courts have yet to back away from *Quill*.¹⁹⁵ Further, imposing taxes directly on Internet retailers may not accomplish any more than could have been accomplished through suits under the CCTA or possibly Jenkins Act.¹⁹⁶ In combating Internet evasion, banning direct to consumer mailing sales, combined with agreements with private carriers, will be a more effective approach than battling over Jenkins Act reports, although a ban on the use of the U.S. Postal Service for shipments could help in this area.

2. Evasion via Smuggling

Straightforward smuggling remains a significant source of evasion without an easy legislative fix. The legal tools to combat outright smuggling already exist. States have their own criminal tax evasion laws and can refer cases to federal authorities when they face barriers to establishing jurisdiction. To the extent federal law enforcement officials are unwilling to prosecute, states could seek to have their

<http://www.accountingweb.com/item/107777>. Even were such legislation to pass, it would give the power for states to sue when Internet retailers did not collect use taxes, but for cigarettes they may already have this power through the Jenkins Act or CCTA. See *supra* notes 146, 154, and accompanying text.

¹⁹⁵ See *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992) (holding that a retailer must have a physical presence in a state to be subject to tax therein); Samantha K. Graff, *State Taxation of Online Tobacco Sales: Circumventing the Archaic Bright Line Penned by Quill*, 58 FLA. L. REV. 375 (2006) (arguing that *Quill* should not be applied to tobacco excise taxes and that *Quill* is ill-considered in light of changes to the economy); see also *Hemi Group v. City of New York*, 130 S. Ct. 983, 994 (2010) (Ginsburg, J., concurring) (citing *Quill*); Robert Plattner et al., *A New Way Forward for Remote Vendor Sales Tax Collection*, 55 STATE TAX NOTES MAG. 187 (2010) (recommending that states adopt legislation that would lead to litigation that could overturn *Quill*).

¹⁹⁶ See *supra* text accompanying notes 146–53.

own personnel appointed as Special Assistant U.S. Attorneys to bear the burden of bringing charges.¹⁹⁷ Still, simply piling up federal criminal penalties is not a solution.¹⁹⁸ Unraveling such networks is a matter of commitment to criminal investigation.¹⁹⁹ Hindering their efforts is a matter of law enforcement approaches and technology.²⁰⁰ Nonetheless, states must grapple with such problems to be effective because of the limited capacity of federal law enforcement. Even where federal enforcement agencies do investigate, because of the essentially local nature of illegal cigarette retail sales, states will have to work closely with federal authorities.²⁰¹

¹⁹⁷ See *supra* note 74 (reluctance of some federal prosecutors to bring charges); cf. *United States v. Jones*, 36 F. Supp. 2d 304, 307 (E.D. Va. 1999) (describing Project Exile); PROJECT EXILE, U.S. ATTORNEY'S OFFICE – EASTERN DISTRICT OF VIRGINIA, http://www.ojjdp.ncjrs.gov/pubs/gun_violence/profile38.html (last visited Mar. 4, 2010) (describing gun control initiative in which Commonwealth's Attorneys for Richmond were cross-designated as Special Assistant U.S. Attorneys to bring federal charges against defendants where state law was considered inadequate).

¹⁹⁸ Cf. Philip J. Cook & Jens Ludwig, *Principles for Effective Gun Policy*, 73 *FORDHAM L. REV.* 589, 604 (2004) (“Deterrence research suggests that crime is generally more responsive to changes in the perceived likelihood of punishment, than to changes in the severity.”).

¹⁹⁹ See *Federal Government Aggressively Enforces State Tobacco Laws*, *supra* note 86, at 86 (“ATF officials added that the best way to address the illegal transport and sale of contraband cigarettes is by attacking the entire black market network.”).

²⁰⁰ For example, California obtained some successes through improvements in the quality of their stamps, hindering counterfeiters. See LINDBLUM, *supra* note 40, at 1; see also Robertson, *supra* note 40 (predicting some reluctance to enact a stamping system in North Carolina in part because of the estimated annual cost to the state of \$6.6 million to run the stamping system). New York has adopted aggressive approaches to investigate illegal gun sales, demonstrating that a state need not necessarily consider itself hamstrung by geographic limitations. See Adam Lisberg, *Stay Away, Ya Varmints! Don't Try Gun Stings Here, Gun-Lovin' W. Va. Pol Warns Mike*, N.Y. DAILY NEWS, Feb. 15, 2010, at 2 (describing New York's use of private investigators to investigate illegal gun sales in West Virginia).

²⁰¹ See Daniel C. Richman, *The Changing Boundaries Between Federal and Local Law Enforcement*, in 2 *CRIMINAL JUSTICE 2000*, BOUNDARY CHANGES IN CRIMINAL JUSTICE ORGANIZATIONS 81, 93 (Charles M. Friel ed.,

States may object to the high costs of cigarette smuggling investigations, but these costs are a function of the nature of state cigarette taxation, and will be defrayed through greater revenue from deterrence and from the seizure of cigarettes and smuggling proceeds. For example, the value of the ATF's cigarette seizures alone nearly justifies the entire ATF tobacco budget without even accounting for the increased revenues from deterrence.²⁰² By devoting forces to combating evasion, states can thus profit and improve their financial positions.²⁰³ In any event, while states and local governments must bear these costs, the benefits, too, are local, such that state enforcement prevents the externalization of investigative costs onto the federal government.

Since the available tax differentials make smugglers willing to transport cigarettes long distances, cooperation on tax rates themselves would have to involve several specific low-tax states to have a large impact.²⁰⁴ However, such

2000), available at http://www.ncjrs.gov/criminal_justice2000/vol_2/02d2.pdf ("Even somewhat more organized targets like street gangs are generally too loose-knit to be taken down by the Bureau without extensive local cooperation . . .") (citing Seth Mydans, *F.B.I. Setting Sights on Street Gangs*, N.Y. TIMES, May 24, 1992, at 16, available at <http://www.nytimes.com/1992/05/24/us/fbi-setting-sights-on-street-gangs.html?pagewanted=1/>); see also Daniel Richman, *Prosecutors and Their Agents, Agents and Their Prosecutors*, 103 COLUM. L. REV. 749, 769 (2003) ("[S]tate and local enforcement agencies have found it politically and financially expedient to develop robust alliances with their federal counterparts The balance of power in this area may recently have shifted, as state and local enforcers have moved from being principally supplicants . . .").

²⁰² See *supra* note 177 and accompanying text.

²⁰³ For example, Maryland may suffer the most cigarette smuggling in the nation, yet it does not devote significant law enforcement efforts to combating evasion. Jay Hancock, *Boost in Md. Cigarette Taxes a Boon for Smugglers*, BALTIMORE SUN, Jan. 27, 2010, at 3A ("[The comptroller's field enforcement] office has fewer than two dozen people to stop tobacco smuggling.").

²⁰⁴ Cf. Robertson, *supra* note 40 (smuggling from North Carolina to Michigan); PATRICK FLEENOR, TAX FOUNDATION, CALIFORNIA SCHEMIN': CIGARETTE TAX EVASION AND CRIME IN THE GOLDEN STATE (2006), <http://www.taxfoundation.org/research/show/1911.html> (smuggling from North Carolina to California); *US Attorney - Glendale Man Convicted In*

complete cooperation is unlikely.²⁰⁵ Not only would such tax increases in low-tax states have a direct impact on voters, but the low-tax states have no way to enjoy the benefits of the positive externality to high-tax states. Indeed, since cigarette smuggling shifts the legitimate sale of cigarettes from high-tax to low-tax states, low-tax states enjoy a revenue benefit from the smuggling.²⁰⁶ Thus, low-tax states would have to adopt policies that reduced their own revenues to combat tax evasion in other states.

Even without large-scale cooperation, states could benefit from some measure of cooperation. As an example, a coalition of state attorneys general was able to enter into an agreement with credit card companies to prevent the use of their cards as payment for on-line tobacco sales.²⁰⁷ Effective state regulation of wholesalers and stamping agents in one state can help prevent illegal untaxed sales in other states. While state cooperation on tax rates is difficult, given the

Cigarette Smuggling Conspiracy, LAW FUEL, Apr. 24, 2008, <http://www.lawfuel.com/show-release.asp?ID=17753> (additional smuggling ring from North Carolina to California).

²⁰⁵ See, e.g., Robertson, *supra* note 40 (explaining that North Carolina might not begin using cigarette stamps because of the \$6.6 million cost to the state); Robert Behre, *House OK's Cigarette-Tax Increase*, POST & COURIER (Charleston), Apr. 3, 2009, at A1, available at http://www.postandcourier.com/news/2009/apr/03/house_oks_cigarette_tax_increase77455/ (explaining that South Carolina's legislative approval of a cigarette tax increase from \$0.07 per pack to \$0.57 per pack would be "hard to get").

²⁰⁶ For example, it was reported that North Carolina lawmakers might have second thoughts about instituting a tax stamping system that would cost \$6.6 million per year and that smuggling out of North Carolina is estimated at 18 million packs per year. See Robertson, *supra* note 40. With North Carolina's \$0.57 per pack cigarette tax, a total elimination in smuggling exports would cost the state \$10.3 million per year in foregone tax revenue alone. With lower sales to smugglers, in-state retailers and wholesalers would presumably have lower income, leading to additional tax losses, since North Carolina has a corporate income tax. See North Carolina Department of Revenue Corporate Income Tax Information, <http://www.dornc.com/taxes/corporate/> (last visited Mar. 25, 2010).

²⁰⁷ Press Release, Attorney Gen. of Mont., Attorneys General, ATF Join with Credit Card Companies to Prevent Illegal Cigarette Sales Over the Internet (Mar. 17, 2005), available at <http://www.doj.mt.gov/news/releases2005/03172005.asp>.

different state policies regarding tobacco consumption, even limited cooperation on tax rates and approaches could yield benefits.²⁰⁸ Since, ultimately, interstate diversion is driven by differential tax rates, states can provide benefits to neighbors by reducing tax differentials, which could be negotiated in exchange for other concessions.²⁰⁹

V. CONCLUSION

States face increasing pressure on their budgets, and tobacco taxes offer a popular and potentially lucrative means of addressing this pressure.²¹⁰ As tobacco taxes continue to rise, tax differentials will grow, increasing the returns to smuggling and exacerbating an already serious problem.²¹¹ While states will be tempted to turn to federal help to combat their evasion problems, federal ability to aid is limited.²¹² The Supreme Court's decision in *Hemi Group* restricts the set of legal tools that local governments—and potentially even states—have in trying to bring enforcement suits.²¹³

²⁰⁸ For example, North Dakota not only is unusual in not requiring tax stamps, but also has an excise tax rate far below its neighbors (\$0.44 per pack in North Dakota vs. \$1.50 per pack in Minnesota, its next cheapest neighbor). See OIG REPORT, *supra* note 2, at 10.

²⁰⁹ For example, Maryland suffers significant evasion due to the tax differential with its neighbor Virginia. See Hancock, *supra* note 203. Even North Carolina, with some of the lowest cigarette taxes in the nation, may be the target of cigarette smuggling from neighboring South Carolina, which charges \$0.38 per pack less. See Robertson, *supra* note 40. Note that even uniform tax rates would not directly solve the problem of untaxed on-reservation sales. Smugglers could still use reservations as their source of untaxed cigarettes, although enforcement would presumably be easier with fewer sources of low-tax cigarettes to monitor. Cf. OIG REPORT, *supra* note 2, at 1 (noting alcohol enforcement is less problematic than tobacco enforcement in part because alcohol diversion is limited to specific geographic areas).

²¹⁰ See *supra* Part I.

²¹¹ See *supra* Part I.

²¹² See *supra* Part IV.

²¹³ See *supra* Part III.

Nonetheless, even to the extent states or local governments still can try to bring civil suits against Internet retailers, they are of only limited value in combating evasion.²¹⁴ Civil suits alone cannot stop smuggling or illicit Internet retail sales.²¹⁵ The additional tools states could be given by federal legislation would be of only limited, incremental value.²¹⁶ Beyond reliance on federal statutes and investigative forces, states have to take responsibility for developing their own enforcement techniques and resources that ensure tax collection.²¹⁷ Failure to do so will reward both smugglers and consumers willing to evade taxes, reducing the equity of taxation. Further, such failures put honest retailers at a competitive disadvantage and harm their businesses.²¹⁸

²¹⁴ See *supra* Part III.B.

²¹⁵ See *supra* Part IV.

²¹⁶ See *supra* Part IV.

²¹⁷ See *supra* Part IV.

²¹⁸ See, e.g., *N.Y. Proposes to Rein in Untaxed Cigarette Sales*, CONVENIENCE STORE NEWS.COM, Feb. 24, 2010, http://www.csnews.com/csn/news/article_display.jsp?vnu_content_id=1004070955 (convenience stores complaining about losing business to Indian reservations due to cigarette tax evasion).

VI. ADDENDUM: THE PACT ACT

In March, 2010, the Prevent All Cigarette Trafficking Act (PACT Act) of 2009 was enacted into law.²¹⁹ Aimed at combating Internet evasion, the PACT Act amends the Jenkins Act and imposes stricter penalties and regulations for interstate sales.²²⁰ While the Act will presumably not affect smuggling itself, it could potentially impact the volume of Internet sales.²²¹

Specifically, the Act requires Internet retailers to collect state and local excise taxes prior to delivering cigarettes in interstate sales.²²² Penalties for violation were increased to up to three years in prison or a civil monetary penalty.²²³ State Attorneys General and local corporation counsels can bring suit against violators to seek injunctions or civil damages.²²⁴ The Act also bans most shipments of cigarettes

²¹⁹ Prevent All Cigarette Trafficking Act (PACT Act) of 2009, Pub. L. No. 111-154, 124 Stat. 1087 (2010).

²²⁰ See Sec. 1, 124 Stat. at 1087. Note the PACT Act does not apply to cigars. See Sec. 2(a), § 375(2)(B), 124 Stat. at 1088.

²²¹ See, e.g., *Press Release, Seneca Nation of Indians, Seneca Nation of Indians Calls House Approval of PACT Act a 'Sucker Punch' to Treaty Rights* (Mar. 17, 2010), available at http://www.bizjournals.com/charlotte/prnewswire/press_releases/national/New_York/2010/03/17/NY72589 (claiming Act will lead to job losses and postal service revenue declines).

²²² Sec. 2(c), § 376a(d)(1)(A), 124 Stat. at 1093. The Act requires interstate retail sales to abide by state and local laws as if the sale occurred in the state or locality of delivery. Sec. 2(c), § 376a(2A)(a), 124 Stat. at 1091.

²²³ Sec. 2(d), § 377, 124 Stat. at 1100. Tribal governments are exempt from criminal penalty. § 377(a)(2)(A). Civil penalties for those other than common carriers are the greater of two percent of gross cigarette sales for the year ending on the date of violation or else \$5000 for a first offense or \$10,000 after the first offense. § 377(b)(1)(A).

²²⁴ Sec. 2(e), § 378(c)(1)(A), 124 Stat. at 1101. Tribal governments also may bring suit. *Id.* The Act extended report filing requirements to include filing reports with local and tribal tax authorities. Sec. 2(b)(2)(D), § 376(a)(3), 124 Stat. 1087, 1090 (2010). The sovereign immunity of tribal governments is not, however, waived for suits brought by states or localities. Sec. 2(e), § 378(c)(1)(B), 124 Stat. at 1101.

through the U.S. postal service.²²⁵ Further complicating Internet sales, currently major private carriers will not ship cigarettes from Internet retailers pursuant to agreements made with the states.²²⁶ Even to the extent some private carriers will remain available to ship cigarettes, those carriers will face more stringent regulation and penalties going forward.

While states may have already had the power to bring civil suits for Jenkins Act violations,²²⁷ clarifying the legal basis for such suits and imposing fixed civil damages should make them more attractive as an enforcement method, although states will face the same difficulty in identifying and enforcing judgments against rogue retailers.²²⁸ The Act does not empower states with any new criminal authority, so their added enforcement power is limited to their ability to bring effective civil suits. The increased federal criminal penalties under the PACT Act might help reduce the problem of a lack of motivation to bring prosecutions,²²⁹ but the penalties remain low.²³⁰

Regardless of the impacts the legal changes may have, the changes the Act makes to the logistics of shipping seem

²²⁵ Prevent All Cigarette Trafficking Act (PACT Act) of 2009, Pub. L. No. 111-154, Sec. 3(a), § 1716E(a)(1), 124 Stat. 1087, 1103 (2010).

²²⁶ See Gale Courey Toensing, *Senate Passes 'Termination Era' PACT Act; Tribal Leaders Will Continue Fight*, INDIAN COUNTRY TODAY, Mar. 16, 2010, <http://www.indiancountrytoday.com/archive/87793387.html>; *FedEx Clamps Down on Cigarette Delivery*, ConsumerAffairs.com, Feb. 7, 2006, http://www.consumeraffairs.com/news04/2006/02/tobacco_fedex.html.

²²⁷ See *supra* Part III.

²²⁸ The PACT Act directs the Attorney General of the United States to maintain a list of noncompliant delivery cigarette sellers. Sec. 2(c), § 376a(e)(1), 124 Stat. at 1093. To the extent the Attorney General does in fact identify rogue retailers states will be saved some investigative cost, though they will still have to identify violations occurring within their jurisdiction.

²²⁹ See *supra* note 74 and accompanying text.

²³⁰ Cf. *supra* note 61 and accompanying text (describing the penalties for CCTA violations to be minimal). CCTA violations are punishable by up to five years in prison. 18 U.S.C. § 2344(a) (2006).

likely to have a real effect.²³¹ Increasing the cost and difficulty of shipping cigarettes alone should reduce the rate of online evasion by limiting supply. High-volume retailers in particular will be forced to switch to minor private carriers, limiting sales.²³²

Small, rogue Internet retailers might be capable of evading restrictions,²³³ but such retailers would essentially be part of the larger straightforward smuggling problem. While significant tax differentials remain, incentives to smuggle will remain, and states will have the same interest in investing resources in combating smuggling.²³⁴

²³¹ See, e.g., *Salamanca Business Adjusts to PACT Act*, POST-JOURNAL (Jamestown), Apr. 4, 2010, at 1, available at <http://www.post-journal.com/page/content.detail/id/554797.html?nav=5003> (describing a retailer planning to exit the business after postal service ban); cf. David D. Kirkpatrick, *Senecas See Comeback over Sale of Cigarettes*, N.Y. TIMES, Mar. 6, 2010, at A12, available at <http://www.nytimes.com/2010/03/06/us/06seneca.html> (attributing declines in Seneca cigarette sales to the private carrier ban that forced a shift to using the postal service).

²³² See Kirkpatrick, *supra* note 231.

²³³ See *supra* note 188 and accompanying text.

²³⁴ See *supra* Part IV.B.2.