

**HCR 3030**

**STATEMENT OF MICHAEL THORNE-BEGLAND  
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AND ASSITANT GENERAL COUNSEL  
ALTRIA CLIENT SERIVICES INC.**

**SUBMITTED ON BEHALF OF PHILIP MORRIS USA INC.  
SENATE FINANCE AND TAX COMMITTEE  
IN SUPPORT OF ND HCR 3030 – TAX STAMP STUDY RESOLUTION**

Altria Client Services Inc., on behalf of Philip Morris USA Inc. (“PM USA”),<sup>1</sup> submits this testimony regarding HCR 3030, which would require North Dakota Legislative Management to study the feasibility and desirability of cigarette tax stamps and report any findings to the next Legislative Assembly.

PM USA supports the North Dakota Legislature’s efforts to research the need for and value of applying state excise tax stamps to cigarette packs sold in the state. PM USA believes that the application of wax-based state excise tax stamps is an important component of a comprehensive approach to address the illicit cigarette trade, which decreased North Dakota’s cigarettes excise tax revenue in 2010 by an estimated \$613,000.<sup>2</sup> Because cigarette excise tax rates vary from state to state, it is important that each state require excise tax stamps that signify the tax paid status of the pack and identifies that the pack is for sale in that specific state.

We are optimistic that an in-depth analysis of the feasibility and desirability of cigarette tax stamps in North Dakota will support the enactment of tax stamp legislation to address the illicit trade in tobacco through wax-based tax stamps during the next Legislative Assembly.

<sup>1</sup> PM USA, a leading domestic manufacturer of cigarettes, is a wholly-owned subsidiary of Altria Group Inc.

<sup>2</sup> Based on reported 2010 cigarette sales volume. Estimates based on information from the Mackinac Center for Public Policy, “Cigarette Taxes and Smuggling,” 2010 page 3, Graphic 1 and from Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 45 (February 2011); funded in part by Altria Client Services Inc. Estimate derived by multiplying the North Dakota State Excise Tax rate of 44¢ per pack times the difference in reported volume and total consumption.



## **Background**

PM USA commends the committee for holding hearings on legislation relating to the issue of the illicit cigarette trade. The illicit cigarette trade is very lucrative. A large percentage of the price of legitimate cigarettes consists of taxes, making tax evasion alone a strong incentive for smuggling. In their most recent report on illicit tobacco to Congress the U.S. Government Accountability Office ("GAO") concluded that tobacco products face varying levels of taxation in different locations, creating opportunities and incentives for illicit trade.<sup>3</sup> According to the Bureau of Alcohol Tobacco, Firearms & Explosives ("ATF"), illicit cigarette sales have dramatically increased in recent years with the sharp rise in excise taxes throughout the United States.<sup>4</sup> Furthermore, contraband cigarette smuggling has been linked to organized crime and terrorist organizations in the United States.<sup>2,3,5</sup> The illicit sale of cigarettes and other tobacco products has many costs:

- Illicit cigarette sales reduce tax revenues for federal, state and local governments, including North Dakota. A recent 2010 report by the Mackinac Center for Public Policy affirmed a previous estimate that North Dakota was losing 3.01% of its cigarette sales due to contraband cigarette activity. Based on reported 2010 cigarette sales volume, North Dakota should have received an estimated \$613,000 in additional cigarette excise tax revenues.<sup>6</sup>
- Illicit cigarette sales undermine efforts to prevent youth access to cigarettes.
- Illicit cigarette sales deprive revenue from local, law-abiding wholesalers and retailers who fully comply with all applicable laws and thereby find themselves at a competitive disadvantage.

<sup>3</sup> GAO Report – *Illicit Tobacco Various Schemes Are Used to Evade Taxes and Fees*, March 2011

<sup>4</sup> Bureau of Alcohol Tobacco, Firearms & Explosives (ATF) March 2011 *ATF Tobacco Diversion Fact Sheet*

<sup>5</sup> International Journal of Comparative and Applied Criminal Justice. Spring 2008, Vol. 32, No. 1 - *The Nexus of Organized Crime and Terrorism: Two Case Studies in Cigarette Smuggling*

<sup>6</sup> Estimates based on information from the Mackinac Center for Public Policy, "Cigarette Taxes and Smuggling," 2010 page 3, Graphic 1 and from Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 45 (February 2011); funded in part by Altria Client Services Inc. Estimate derived by multiplying the North Dakota State Excise Tax rate of 44¢ per pack times the difference in reported volume and total consumption.

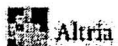


- Contraband cigarette trafficking is used by organized crime syndicates as a source of income to support other criminal activity and is often associated with other more serious crimes.

Some criminals engaged in the illicit cigarette trade exploit the variance in state excise taxes to generate immense illegal profits at the expense of legitimate, tax-paying businesses. To help address this problem, PM USA believes that all states should require that a wax-based tax stamp be affixed to each pack of cigarettes. These stamps should include security features to aid law enforcement authentication and a serial number or, where applicable, a stamp that denotes that the cigarettes are tax-exempt (e.g. qualified Native American sales). North Dakota is one of only three states that do not require tax stamps on cigarette packs.

In our experience, untaxed or under-taxed cigarettes are the most common form of contraband cigarettes. Untaxed or under-taxed cigarettes include those that are sold with no tax stamp in a jurisdiction that requires one, cigarettes with the wrong tax stamp for the jurisdiction in which it was sold, and cigarettes sold with counterfeit tax stamps. PM USA believes that this study bill will identify the risks of the illicit cigarette trade and the benefits of wax-based cigarette excise tax stamping, and thus support the enactment of tax stamping legislation. Wax-based state cigarette excise tax stamps will help reduce the trade in untaxed cigarettes and will help address issues facing the legitimate North Dakota cigarette trade. Among other things, the study bill should consider:

- North Dakota requires a state excise tax to be paid for each pack of cigarettes for qualified sales. Without a state excise tax stamp there is no way to physically



distinguish legitimate tax-free product from product that is subject to the state excise tax.<sup>7</sup> Thus, North Dakota cigarette excise tax revenue is unprotected.

- Law enforcement information indicates that traffickers of contraband cigarettes are intent on buying unstamped cigarettes for their illegal operations.<sup>8</sup> North Dakota's lack of state specific excise tax stamp on cigarette packs may attract criminal cigarette traffickers and organized crime syndicates into the state. Businesses in North Dakota may unknowingly sell unstamped cigarettes to criminals who then re-sell the products to fund other criminal activity.
- As the illicit, unregulated channels grow, the effectiveness of underage access prevention measures in regulated retail trade channels would diminish and jeopardize progress on reducing underage initiation. In addition, with increased access to cigarettes through the illicit market comes the likely exposure of minors to other criminal activities associated with those markets.
- Wax-based stamping system is an efficient cost-effective approach to stamping cigarettes and provides an effective tool to combat cigarette diversion. Wax-based stamps provide law enforcement with the tools they need to determine if a tax stamp is genuine; state governments a better method to collect tax revenue; and multi-state wholesalers a single stamping system. Wax-based cigarette excise tax stamps are currently in use in 45 states. They can cost as little as 50¢ per thousand<sup>9</sup>. Expensive solutions such as encrypted tax stamp systems can impose

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<sup>7</sup> Native American cigarette sales not covered by a state tobacco tax compact in North Dakota are exempt from state excise taxes for sales to tribal members and sales of two-hundred cigarettes or less to non-tribal members.

<sup>8</sup> April 28th, 2010 BNO news *Glendale, CA man sentenced for smuggling cigarettes*

<sup>9</sup> June 3, 2008 letter from Patrick O'Conner, Assistant State Treasurer of New Jersey regarding Senate Bill No. 1545



significant costs on the distribution system with few benefits not already offered through serialized stamps.<sup>10</sup>

- Serialized wax-based cigarette excise tax stamps enable law enforcement to determine the identity of the wholesaler that applied the tax stamp; a useful tool when attempting to investigate contraband issues.
- Authentication technology is available for wax-based tax stamps that provide law enforcement the ability to readily determine if stamps are genuine or counterfeit.
- The majority of wholesalers who ship cigarettes to North Dakota retailers also ship to surrounding states that require wax-based tax stamps. Thus, these wholesalers have the machines necessary to apply the wax-based tax stamps currently utilized by other states.

### Conclusion

PM USA supports North Dakota's efforts to study the feasibility and desirability of cigarette tax stamps and the resulting impact on the illicit cigarette trade. There is a wealth of information available that documents the scope and consequences of the illicit cigarette trade and the benefits of state cigarette excise tax stamps. We believe that if North Dakota decides to pursue the study, Legislative Management will discover the value of wax-based cigarette excise tax stamps far outweighs the minimal cost of introduction. We welcome the opportunity to work with North Dakota to address its contraband cigarette issues.

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<sup>10</sup> The Indiana Department of Revenue concluded in their report on a conversion to an encrypted tax stamp system that maintaining a wax-based system was of greatest benefit to the state: "... [E]ncrypted stamps do not provide a significant impact in reducing contraband cigarette sales [...] furthermore cannot justify the minimum estimate of spending \$2.9 million per year of taxpayer money to support implementing an encrypted-stamp program. Nor [...] the estimated \$12.5 million to \$15 million [...] it would cost Indiana's cigarette distributors." – From *Changing the Cigarette Tax Stamp: Feasibility Study Report*, Indiana DOR November 1, 2009.

