

State of Hawaii
Department of the Attorney General



ANNUAL REPORT
OF THE
TOBACCO ENFORCEMENT UNIT

For Fiscal Year 2003-2004

Submitted to
The Twenty-Third State Legislature
Regular Session of 2005

TABLE OF CONTENTS

INTRODUCTION	1
TOBACCO MASTER SETTLEMENT AGREEMENT	2
A. Background.....	2
B. MSA Payments.....	2
C. Duties of the Attorney General and State's Tobacco Liability Act ...	3
Enforcement of the MSA and HRS chapter 675	3
MSA ENFORCEMENT ACTIVITIES IN FISCAL YEAR 2003-2004	5
CIGARETTE TAX STAMP ENFORCEMENT	6
Wholesalers and Distributors.....	7
Retail Store Inspections and Arrests.....	7
Coordination with Federal and other States' Agencies	8
"Gray Market" or Prohibited Export and Foreign Cigarette Contraband....	8
Counterfeit Tax Stamps	8
Half-Stamping	9
Continuing Enforcement	9
Cigarette Tax Revenues.....	9
FUNDING FOR FISCAL YEAR 2003-2004	11
Appropriations for Fiscal Year 2003-2004: \$940,000.....	11
Expenditures for Fiscal Year 2003-2004: \$730,885.....	11
TOBACCO ENFORCEMENT UNIT'S EXPENDITURES FY 2003-2004	12
CONCLUSION.....	12

INTRODUCTION

Section 28-15(d), Hawaii Revised Statutes (HRS), requires the Department of the Attorney General to submit a report to the Legislature, no later than twenty days prior to the convening of each regular session, providing an accounting of the receipts and expenditures of the Tobacco Enforcement Special Fund.

The Tobacco Enforcement Unit (Unit) was formed on July 1, 2000,¹ in response to the Attorney General's obligation to enforce the Master Settlement Agreement (MSA); chapter 675, Hawaii Revised Statutes (HRS chapter 675, State's Tobacco Liability Act, "TLA"); and the cigarette tax stamp requirements and prohibition against the sale of prohibited export and foreign cigarettes as codified in chapter 245, Hawaii Revised Statutes (HRS chapter 245).

The Unit consists of a unit supervisor, cigarette tax prosecutor, MSA civil prosecutor, legal clerk, legal assistant, and five criminal investigators. An investigator/auditor is being sought to complete the Unit.

In fiscal year 2003-2004, the State received in excess of \$37.7² million in MSA settlement moneys. As of the end of June 2004, the State has received in excess of \$212.6 million in MSA settlement moneys. In fiscal year 2003-2004, the Unit received \$350,000 in MSA settlement moneys and incurred expenditures of \$206,589.89 in diligently enforcing HRS chapter 675 and the MSA.

Due to diligent enforcement, cigarette tax revenues for fiscal year (FY) 2003-2004³ increased \$6,955,450 million or approximately 9.8 percent over the comparable period in FY 2002-2003. Moreover, an increase in tax rate coupled with continued vigorous enforcement has significantly contributed to the \$37.5 million or approximately 93.6 percent increase in cigarette tax revenues in FY 2003-2004 over FY 1999-2000.

CIGARETTE TAX REVENUES BY FISCAL YEAR:

FY 1999-2000	\$40,049,539
FY 2000-2001	\$51,739,469
FY 2001-2002	\$62,609,477
FY 2002-2003	\$70,586,392
FY 2003-2004	\$77,541,843

¹ In keeping with the "diligent enforcement" requirements of the MSA the Department of the Attorney General was engaged in on-going and continuous enforcement efforts prior to the establishment of the Unit in July of 2000.

² MSA payments totaled \$37,793,157.48 for fiscal year 2003-2004.

³ The cigarette tax rate increased on October 1, 2002 from \$.05 per stick (\$1.00 per pack) to \$.06 per stick (\$1.20 per pack). The cigarette tax rate increased to \$.065 per stick (\$1.30 per pack) on July 1, 2003. The cigarette tax rate increased to \$.07 per stick (\$1.40 per pack) on July 1, 2004.

TOBACCO MASTER SETTLEMENT AGREEMENT

A. Background

On November 23, 1998, leading United States tobacco manufacturers, entered into a settlement agreement, entitled the Tobacco Master Settlement Agreement (MSA), with forty-six states, including Hawaii. In consideration for a release of past, present, and certain future claims against them, the MSA obligates these manufacturers to pay substantial sums to the settling states (tied in part to the volume of tobacco product sales). The Attorney General of each state is responsible for enforcing the provisions of the MSA.

B. MSA Payments⁴

MSA Payments include two types of payments:

--Initial Payments: The initial payments were payments to be received annually beginning January 10, 1999⁵, through January 10, 2003. The last initial payment was received on January 10, 2003. Total Initial Payments amounted to \$65,029,741.67.

<u>FY 1999-2000</u>	<u>FY 2000-2001</u>	<u>FY 2001-2002</u>	<u>FY 2002-2003</u>	<u>TOTAL</u>
\$27,804,177.13	\$11,659,558.77	\$12,701,627.03	\$12,864,378.74	\$65,029,741.67

--Annual Payments: These annual payments are payments to be received beginning April 15, 2000 and on April 15 of each year thereafter in perpetuity. The annual payment received in fiscal year 2003-2004 was \$37,793,157.48. Total Annual Payments received through fiscal year 2003-2004 equal \$147,595,933.77.

<u>FY 1999-2000</u>	<u>FY 2000-2001</u>	<u>FY 2001-2002</u>	<u>FY 2002-2003</u>	<u>FY 2003-2004</u>	<u>SUBTOTAL</u>
\$20,811,042.90	\$24,471,822.21	\$32,674,220.28	\$31,845,690.90	\$37,793,157.48	<u>\$147,595,933.77</u>
					\$212,625,675.44

--Total of MSA payments received through fiscal year 2003-2004 is \$212,625,675.44.

⁴ The reporting of the MSA payments in this year's legislative report differs from prior years due to adjustments made to the reported figures in order to reflect the receipt of MSA payments strictly on a cash basis as received each fiscal period. In prior reports the MSA payments were reported on a calendar year basis.

⁵ The payment that was to be received in FY 1998-1999 was not received until December 14, 1999.

C. Duties of the Attorney General and State's Tobacco Liability Act

In conjunction with the MSA, the Attorney General of Hawaii is tasked with enforcing the State's Tobacco Liability Act (TLA), HRS chapter 675.

The purpose of the TLA is to hold tobacco product manufacturers accountable for the harm caused by the sale of cigarettes to citizens of the State. As stated in section 675-1:

It is the policy of the State that financial burdens imposed on the State by cigarette smoking be borne by tobacco product manufacturers rather than by the State to the extent that such manufacturers either determine to enter into a settlement with the State or are found culpable by the courts It would be contrary to the policy of the State if tobacco product manufacturers who determine not to enter into such a settlement with the State could use a resulting cost advantage to derive large, short-term profits It is thus in the interest of the State to require that such manufacturers establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short-term profits and then becoming judgment-proof before liability may arise⁶.

In fiscal year 2003-2004 the Unit was tasked with the added responsibility of creating and making available for public review a directory of compliant cigarettes and roll your own tobacco products. The directory was posted on the Internet on October 31, 2003, and has been revised and updated throughout fiscal year 2003-2004. The directory contains information on 49 compliant tobacco product manufacturers and includes a listing of 480 authorized brands of cigarettes and roll your own tobacco.

Enforcement of the MSA and HRS chapter 675⁷

A crucial relationship exists between the MSA and the TLA. The MSA and TLA represent affirmative steps toward holding tobacco manufacturers responsible for the many financial burdens imposed on the State. HRS chapter 675 requires any tobacco product manufacturer selling cigarettes to consumers within the State (whether directly or through a distributor, retailer, or similar intermediary or intermediaries) to either become a participating manufacturer and generally perform its financial obligations under the MSA or place funds into an escrow account to establish a reserve fund to guarantee a source of compensation to the State should such tobacco product manufacturers be found culpable by the courts.

⁶ HRS chapter 675, §675-1.

⁷ It should be noted that during the 2003 regular session two pieces of legislation were introduced and passed (Act 77 and Act 177, Session Laws of Hawaii 2003) that will facilitate the Attorney General's on-going diligent enforcement efforts.

With regard to the enforcement of the MSA and HRS chapter 675, in fiscal year 2003-2004 the Unit identified eighteen non-participating manufacturers. A non-participating manufacturer (NPM) is a tobacco product manufacturer who has not entered into the tobacco master settlement agreement, whose product is being sold in the State. In order to identify such NPMs, the Unit has developed a system that:

- (1) Identifies NPMs and their products;
- (2) Gathers and tracks information on NPM product;
- (3) Notifies NPMs of their obligations under HRS chapter 675, HRS chapter 486P, and their related statutes (the Unit accomplished this task by mailing letters to tobacco product manufacturers (worldwide) advising them of the requirements of HRS chapter 675, HRS chapter 486P, and their related statutes);
- (4) Follows through with assistance to effectuate compliance; and
- (5) Provides the information gathering and certification protocols necessary to establish and publish the directory of tobacco product manufacturers whose cigarettes and roll your own tobacco are authorized to be sold in the State.

How is this accomplished? Armed with a list of wholesalers and distributors the Unit has created a reporting form, mailed the form to the wholesalers and distributors, and started to gather information based on responses and invoices submitted to the Unit by the wholesalers and distributors. Based on the information contained in the invoices the Unit compiled a list of NPMs and their cigarette brands being sold in Hawaii. The Unit's list is supplemented by information from time-to-time from other states that were willing to share their lists of NPMs and brands. In addition, the Unit will continue to actively investigate and identify brands of cigarettes that are on store shelves in an attempt to identify all of the NPMs who have cigarettes for sale in Hawaii.

Ferretting out individual manufacturers and their respective brands is a time consuming process that has been facilitated by the implementation of the directory statute, HRS section 486P-6. Once any tobacco product manufacturer is identified as having sales or intends to have sales within the State, a notice is sent to inform the tobacco product manufacturer that it is required to register with the Unit in compliance with HRS section 486P-5 and comply with all of the requirements of HRS chapter 486P. In the case of NPMs that actually have sales directly or indirectly into the State, sales data is accumulated and formal demands are sent to the NPMs each year requiring that the appropriate sums be placed in a qualified escrow fund in compliance with HRS chapter 675. One obstacle to enforcement efforts is cigarettes ordered and imported into the State by entities other than known wholesalers and distributors. For example, cigarettes are often ordered by consumers or retail stores via the Internet, by phone, or by mail order⁸. Retail inspections are the key to uncovering Internet, phone order, or mail order shipments. Newly enacted legislation, Act 157, Session Laws of Hawaii 2004, is

⁸ In the 2004 regular session, the Attorney General testified in favor of legislation (see Act 157, Session Laws of Hawaii 2004) that prohibits the illegal shipment of Internet, mail order, and phone order cigarettes into the State of Hawaii.

designed to address this problem and encourage compliance with federal law and reporting to the State Department of Taxation with regard to cigarettes and other tobacco products that are evading the payment of state taxes. In past conversations with storeowners, the Unit has learned of another enforcement barrier: peddlers are offering cigarettes bought at military bases to merchants for resale.⁹ These two types of cigarette sales are significant because the NPM sales and untaxed cigarette sales affect the amount of moneys available for disbursement under the MSA. An NPM who elects not to join the MSA and who does not comply with the escrow requirements of HRS chapter 675 enjoys a price advantage over compliant tobacco manufacturers. This price advantage has the potential of luring consumers away, thus affecting the market share of the participating manufacturers. The increase of sale of cigarettes by NPMs is not an academic issue. In a recent MSA disbursement, the amounts due to the states were reduced due to a national increase in NPM market share.

It should be noted that the MSA requires the State to "diligently enforce" the requirements of the "model statute" (codified as HRS chapter 675 (TLA)). Failure to "diligently enforce" the TLA may result in a state losing a significant portion of its MSA payments. "Diligent enforcement" in the context of MSA enforcement has not been clearly defined. However, we believe that "diligent enforcement" includes:

- (A) Identification of the NPMs and the number of NPM cigarettes sold in the State;
- (B) Notification to the NPMs of their obligations to establish and fund an escrow in accordance with HRS chapter 675; and
- (C) The filing of complaints in court against non-compliant NPMs seeking compliance with the HRS chapter 675.

MSA ENFORCEMENT ACTIVITIES IN FISCAL YEAR 2003-2004

- \$37,793,157.48 paid to the State under the MSA.
- Eighteen NPMs sold (whether directly or through a distributor, retailer, or similar intermediary or intermediaries) cigarettes to consumers within the State; fifteen complied with HRS chapter 675; litigation was initiated in FY 2003-2004 against two of the NPMs. Litigation was initiated against the third NPM shortly after the end of FY 2003-2004. The three lawsuits are pending.
- Four default judgments were obtained in FY 2003-2004. These default judgments were entered against non-compliant NPMs that were sued in prior years.
- Pursuant to HRS chapter 675, for 2003 sales fifteen NPMs placed \$55,933.82 into qualified escrow funds (92.7% compliance rate).

⁹ In the 2001 regular session, the Attorney General testified in favor of legislation that further clarified the prohibition against the resale of military cigarettes.

- Pursuant to HRS chapter 486P, the Attorney General posted a tobacco directory listing compliant tobacco product manufacturers and their brands.
- Pursuant to HRS chapter 245, only those cigarettes listed in the tobacco directory may be stamped and sold.
- At the end of FY 2003-2004 thirty-eight participating manufacturers are listed in the tobacco directory.
- At the end of FY 2003-2004 eleven¹⁰ NPMs are listed in the tobacco directory.

CIGARETTE TAX STAMP ENFORCEMENT

The 2000 Legislature recognized the need for a mandatory cigarette tax stamp system as a means, "to assess, collect, and enforce the cigarette and tobacco tax." The Conference Committee Report on S.B. No. 2486, S.D.2, H.D. 2, C.D. 1 (2000)¹¹ noted that the former system of taxation was ineffective and haphazard:

. . . [E]nforcement of the current system of collecting cigarette and tobacco taxes is sporadic, haphazard, and ineffective, resulting in uncollected potential tax revenue. The current system of filing of returns by licensed dealers is in effect a system of voluntary compliance. Persons may try to sell cigarettes and tobacco products without obtaining a license, or could have a license and not file a return or understate the income on the return.

The Legislature also recognized that obtaining actual proof of large-scale black market cigarette sales is nearly impossible due to the nature of the activity, which is necessarily surreptitious, and the limited available resources. Nonetheless, the Legislature concluded that actual proof of magnitude of the black market was unnecessary, "judging from the anecdotal evidence existing and continuing over a fifteen-year period that a black market exists".

With these concerns in mind, HRS chapter 245 was amended to require that the tax imposed under HRS section 245-3, upon the sale or use of cigarettes shall be paid by licensees through the use of stamps. As a result, beginning January 1, 2001, a licensee or its authorized agent or designee was required to affix a stamp to the bottom of each individual package of cigarettes prior to distribution. Beginning April 1, 2001, no individual package of cigarettes shall be sold or offered for sale to the general public

¹⁰ While 18 NPMs sold cigarettes in the State in FY 2003-2004 only 11 filed a certification and provided all of the information needed to be listed in the tobacco directory.

¹¹ Act 249, Session Laws of Hawaii 2000, codified as amendments to HRS chapter 245.

unless affixed with the stamp as required by HRS chapter 245¹². Diligent enforcement on the part of the Unit has determined the evasion of cigarette taxes as amounting to at least \$22 million annually as reflected by the increase in cigarette tax revenues of \$22 million in FY 2001-2002 over FY 1999-2000.

Wholesalers and Distributors

Beginning in July 2001, the Unit worked closely with the wholesalers and dealers (who were licensed stampers) to facilitate the conversion to stamping. The Unit attended numerous meetings in July and August with the Department of Taxation and the licensed stampers to address questions dealing with tax stamping. The Unit also met with the Department of Taxation and the provider of the tax stamps (Meyercord Corporation) to facilitate the acquisition of a tax stamp for the program. Beginning in January 2001, the Unit began to inspect stampers for compliance with the tax stamp program. Six of the 150 felony arrests for tax stamp violations have involved licensed stampers.

Retail Store Inspections and Arrests

Beginning April 1, 2001, the Department of the Attorney General began a vigorous campaign to seek out those who were violating the cigarette tax stamping requirements of HRS chapter 245.

- There are approximately 1,166 known retail establishments: 766 on Oahu, 165 on Hawaii, 163 on Maui, and 72 on Kauai. This total does not include restaurants, bars, food-vans, or peddlers at swap meets. Inspections have been conducted on the islands of Kauai, Oahu, Maui, Molokai, and Hawaii. Felony arrests have been made on the islands of Oahu, Maui, Hawaii, and Kauai.
- In fiscal year 2003-2004 over 1,900 HRS chapter 245 compliance inspections were conducted statewide, which resulted in 12 felony arrests for HRS chapter 245 violations.
- Since April 1, 2001, inspections have resulted in over 150 felony arrests and the seizure of over 2,200,420 illegal cigarettes.
- In fiscal year 2003-2004 8 criminal prosecutions resulted in \$7,300 in fines. In total, the Unit has prosecuted 108 cases resulting in criminal fines of \$162,000.
- In fiscal year 2003-2004 65 administrative forfeiture cases were initiated and filed.
- In fiscal year 2003-2004 36 orders were filed for administrative forfeiture.

¹² In 2002, the Department of the Attorney General testified in favor of legislation that removed the sunset date of June 30, 2006, from the cigarette tax stamp requirements of HRS chapter 245.

- In total, 42 cigarette prosecutions have resulted in court ordered forfeiture of cigarettes as part of a defendant's criminal sanction.

Coordination with Federal and other States' Agencies

The Unit has worked with U.S. Customs in joint investigations of persons smuggling contraband cigarettes into the State from foreign countries.

- The Unit has coordinated with U.S. Customs and has interfaced with the Federal Bureau of Alcohol Tobacco and Firearms, the Royal Canadian Mounted Police, and Canadian Customs and Revenue. In addition, the Unit has developed working relationships with the relevant enforcement agencies in the states of California, Oregon, Washington, and Arizona.

"Gray Market" or Prohibited Export and Foreign Cigarette Contraband

"Gray Market" Cigarettes clearly marked "Tax Exempt" have been found in the State.¹³ These cigarettes are manufactured overseas in such places as: the Philippines, Switzerland, China, Southeast Asia, and Colombia representing a multitude of brands and cigarette manufacturers. In order to address the "Gray Market" problem relationships are being established and information is being shared with the taxing and regulatory authorities in California, Oregon, Washington, Michigan, Florida, Vermont, Utah, Alaska, and Canada. The Unit has also been in contact with the U.S. Post Office, Federal Bureau of Alcohol, Tobacco, and Firearms (ATF), Internal Revenue Service, U.S. Customs Service, Canadian Customs Service, and the Royal Canadian Mounted Police with regard to "Gray Market" cigarettes and other cigarette related issues. The Unit is aware of an attempt by certain mainland distributors to mask or re-label "Tax Exempt" cigarettes in order to avoid prosecution for the sale of "Gray Market" cigarettes.

"Gray Market" cigarettes include cigarettes that: have been imported illegally into the United States in violation of federal law; fail to meet federally mandated labeling requirements; or bear an unauthorized brand or trademark. These are the types of cigarettes that are seized in the Unit's joint interdiction efforts with U.S. Customs at the airports and are often found at small grocery and liquor stores. These types of cigarettes are most often smuggled into the State from Asia, Southeast Asia, the South Pacific, and the Philippines.

Counterfeit Tax Stamps

Working with the enforcement entities in the states of California, Washington, and Oregon the Unit has become aware of the growing presence of counterfeit tax stamps in these jurisdictions. The clear incentive for criminal elements to become involved in counterfeit tax stamping is clear: Hawaii's cigarette tax rate is the fifth highest in the

¹³ The Unit confiscated 209 cartons of "Gray Market" cigarettes that were clearly marked "For Export Only" and their sale would have clearly cut into the market share of the participating manufacturers had they made their way into Hawaii's stream of commerce.

nation at \$.07/cigarette or \$1.40/pack of twenty cigarettes¹⁴. A counterfeit tax stamp that is offered for sale at a price¹⁵ below the \$1.40/pack rate will provide a significant price advantage over vendors who sell properly stamped cigarettes. It is important to note that counterfeit Hawaii tax stamps are in circulation. The Unit is engaged in ferreting out the source of the counterfeit tax stamps.

Half-Stamping

Investigations¹⁶ have resulted in arrests for selling half-stamped or partially stamped packs of cigarettes. By placing a half-stamp on the bottom of a package of cigarettes the cigarette tax is being evaded. By placing a half-stamp on the bottom of a pack a vendor is able to stamp two packs for the price of one (i.e., \$.70 per pack rather than \$1.40 per pack).

Continuing Enforcement

In order to continue its enforcement activities the Unit will be conducting surprise inspections of: wholesalers and distributors; cigarette vending machines; and retail establishments throughout the State for HRS chapter 245 compliance. The Unit will also conduct controlled purchases of Internet retail cigarettes for compliance with Act 157, Session Laws of Hawaii 2004, and of retail stores as a spot check of retail compliance.

Cigarette Tax Revenues

There has been a significant increase in the cigarette tax revenues since the implementation of the Tax Stamp program on January 1, 2001. For the fiscal year that ended June 30, 2001, cigarette tax revenues were \$11,689,930 or 29 percent higher than they were in FY 1999-2000 even though the tax stamp program was in effect only half of the fiscal year and effective enforcement began at the retail level with only three months left in the fiscal year:

FY 1999-2000	FY 2000-2001	INCREASE
\$40,049,539	\$51,739,469	\$11,689,930

The increase is even more dramatic when comparing the fiscal period ending June 30, 2002, to those collected in 2000. The State collected \$62,609,477 in cigarette tax revenues for FY 2001-2002. The State collected \$40,049,539 in cigarette tax revenues

¹⁴ As of July 30, 2004, the Campaign for Tobacco Free Kids reports that the State of Rhode Island has the highest tax rate of \$2.46 per pack. New Jersey is second with a tax rate of \$2.40 per pack. Michigan is third with a tax rate of \$2.00 per pack. Alaska is fourth with a tax rate of \$1.60 per pack. Connecticut and Massachusetts are fifth with tax rates of \$1.51 per pack. New York is seventh with a tax rate of \$1.50 per pack. Washington is eighth with a tax rate of \$1.425 per pack. Hawaii is presently ninth with a tax rate of \$1.40 per pack.

¹⁵ Counterfeit tax stamps may range in price from \$.03 to \$.50 per stamp.

¹⁶ Arrests were made for half-stamping in November 2001. At that time, the Unit seized 12,879 packs, of which 2,639 packs were half-stamped and 10,240 packs were unstamped.

over the same period in FY 1999-2000. Diligent enforcement yielded an increase of over \$22 million or approximately 56 percent:

FY 1999-2000	FY 2001-2002	INCREASE
\$40,049,539	\$62,609,477	\$22,559,938

The \$22 million in increased cigarette tax revenues provides clear evidence that the sale of untaxed cigarettes was firmly entrenched and flourishing with sales of at least 22,559,938 packs or 2,255,993 cartons of cigarettes. The quantity of previously untaxed cigarettes would easily fill 46 forty-foot shipping containers¹⁷.

Due to diligent enforcement, cigarette tax revenues for FY 2003-2004¹⁸ increased \$6,955,451 million or approximately 9.8 percent over the comparable period in FY 2002-2003. Moreover, vigorous enforcement has significantly contributed to the \$37.5 million or approximately 93.6 percent increase in cigarette tax revenues in FY 2003-2004 over FY 1999-2000:

FY 1999-2000	FY 2003-2004	INCREASE
\$40,049,539	\$77,541,843	\$37,492,304

- Discussions with Federal and other state law enforcement agencies have made it clear that cigarette tax evasion is rampant in many jurisdictions. Discussions with officials from the State of California indicate that they estimate that tax losses from cigarette smuggling and counterfeit stamps costs the State of California \$130 million to \$262 million dollars in lost revenue per year. The State of Washington estimates its lost revenues to be \$106 million in cigarette tax revenues. The State of Oregon estimates a \$20 million to \$50 million-dollar gap in actual cigarette consumption versus taxed consumption.

¹⁷ Each forty-foot container holds 960 master cases containing 50 cartons each.

¹⁸ The cigarette tax rate increased on October 1, 2002 from \$.05 per stick (\$1.00 per pack) to \$.06 per stick (\$1.20 per pack). The cigarette tax rate increased to \$.065 per stick (\$1.30 per pack) on July 1, 2003. The cigarette tax increased to \$.7 per stick (\$1.40 per pack) on July 1, 2004.

FUNDING FOR FISCAL YEAR 2003-2004

TOTAL FUNDING: \$1,272,014.34

MSA ENFORCEMENT FUNDS: \$350,000

CIGARETTE TAX STAMP FEES/INT./FINES: \$922,014.34

FY 2002-2003 APPROPRIATIONS/EXPENDITURES:

Appropriations for Fiscal Year 2003-2004: \$940,000

- The Legislature appropriated \$940,000 for MSA and cigarette tax stamp enforcement for fiscal year 2003-2004.
- \$345,000 for MSA enforcement and
- \$595,000 for cigarette tax stamp enforcement.

Expenditures for Fiscal Year 2003-2004: \$730,885

- MSA Enforcement: \$208,408
- Cigarette Tax Stamp Enforcement: \$522,477

TOBACCO ENFORCEMENT UNIT'S EXPENDITURES FY 2003-2004

	<u>MSA</u>	<u>TAX STAMP</u>
APPROPRIATION	\$345,000	\$595,000
PERSONNEL COSTS		
SALARIES AND FRINGE	\$143,951.00	\$405,569.00
OPERATIONAL EXPENSES & OVERHEAD COSTS		
LEASE RENT	\$22,387.38	\$22,387.38
FURNITURE, FIXTURES, & EQUIPMENT	-----	-----
COMPUTERS	-----	-----
TRAVEL	\$3,726.70	\$9,987.79
PHONES	\$1,854.69	\$1,854.69
OFFICE EQUIPMENT	\$4,009.90	\$4,009.90
SUPPLIES	\$1,381.59	\$1,381.59
INVESTIGATION EQUIPMENT	-----	\$16,929.99
EVIDENCE STORAGE	-----	\$3,645.95
MILEAGE	-----	\$10,833.91
MISC. EXPENSES	-----	\$353.71
LITIGATION EXPENSES	\$1,456.00	\$32.36
ADMINISTRATION EXPENSES (EST. ALLOCATION)	\$29,640.58	\$44,460.86
TOTAL EXPENSES	<u>(\$208,408)</u>	<u>(\$522,477)</u>
APPROPRIATION BALANCE¹⁹	<u>\$136,592</u>	<u>\$72,523</u>

CONCLUSION

The unit's activities are critical and time-sensitive if the State is to receive its fair share of the "Tobacco Settlement Funds".

Effective enforcement of the State's Gray Market Statute and Cigarette Tax Stamp requirements will allow the Unit to identify and address any problems that the State may have with black/gray market cigarette sales, and increase State tax revenues by providing a more effective means to assess, collect, and enforce the provisions of HRS chapter 245.

We will be recommending that the 2005 Legislature pass the following measure to assist the Unit with its mission:

¹⁹ Imbedded in the appropriation balances of \$209,115 are personnel costs that were not incurred due to the positions not being filled for the entire fiscal year. Due to the "Temporary" classification of the positions it was difficult for the Unit to find qualified individuals to fill its investigative and auditor positions. The investigator temporary positions were filled in October 2001. The auditor position is yet to be filled. As a result, funds that would otherwise have been used for the auditor salary and fringe benefits reverted to the Tobacco Enforcement Special Fund and the Cigarette Tax Enforcement Special Fund. Due to fiscal restraints placed on all funds by executive order expenses were restricted in the last quarter of FY 2003-2004.

- Legislation that requires a retail outlet to acquire a retail permit for the sale of cigarettes and tobacco products will facilitate the enforcement of HRS chapter 245 by providing a current data base of all businesses engaged in the retail sale of cigarettes and tobacco products. Further, such legislation would have a records keeping component that is currently missing in the enforcement of the sale of cigarettes and tobacco products. Such record keeping would compel retail outlets to keep records of their purchases of cigarettes and tobacco products. Criminal sanctions will be sought for the sale of cigarettes or tobacco products without having the required permit.