State of Hawaii

Department of the Attorney General

ANNUAL REPORT

OF THE

TOBACCO ENFORCEMENT UNIT

For Fiscal Year 2002-2003

Submitted to
The Twenty-Second State Legislature
Regular Session of 2004

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INTRODUCTION

Section 14 of Act 249, Session Laws of Hawaii 2000 (which created the cigarette tax stamp law), requires the Department of the Attorney General to report to the Legislature no later than twenty days prior to the convening of each of the regular sessions of 2002 and 2003 on its activities relating to Act 249, including expenses, fines, penalties collected, and forfeitures. In addition, 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 2002-2003, the State received in excess of $44.6[2] million in MSA settlement moneys. As of the end of June 2003, the State has received in excess of $174.8 million in MSA settlement moneys. In fiscal year 2002-2003, the Unit received $162,713.16 in MSA settlement moneys and incurred expenditures of $206,589.89 in diligently enforcing HRS chapter 675 and the MSA[3].

Due to diligent enforcement, cigarette tax revenues for fiscal year (FY) 2002-2003[4] increased $7,976,915 million or approximately 12.74 percent over the comparable period in FY 2001-2002. Moreover, vigorous enforcement has significantly contributed to the $30.5 million or approximately 76 percent increase in cigarette tax revenues in FY 2002-2003 over FY 1999-2000.

FY 1999-2000	$40,049,539

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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 Includes receipt of $1,046,443.25 from settlement with Brown & Williamson and Star Scientific on contract cigarette manufacturing issues.

3 In FY 2001-2002 the Unit received $356,538 in revenue and incurred $143,654.56 in expenditures leaving an unencumbered cash balance of $209,514.86 to begin FY 2002-2003.

4 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.

FY 2000-2001	$51,739,469
FY 2001-2002	$62,609,477
FY 2002-2003	$70,586,392

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 Payments

MSA Payments include two types of payments:

--Initial Payments: These initial payments are payments to be received annually beginning January 10, 1999, through January 10, 2003. The last initial payment was received on January 10, 2003.

1999	2000	2001	2002	2003	SUBTOTAL
$15,161,138.18	$12,943,949.44	$11,659,558.77	$12,400,716.54	$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.

1999	2000	2001	2002	2003	SUBTOTAL
N/A	$22,115,441.28	$24,490,518.00	$31,351,126.11	$30,782,721.48	$109,802,776.29
					$174,832,571.96

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 arise[5].

Enforcement of the MSA and HRS chapter 675[6]

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.

With regard to the enforcement of the MSA and HRS chapter 675, the Unit has identified twenty-six 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, it was necessary for the Unit to develop a system that would:

(1) Identify NPMs and their products,
(2) Gather and track information on NPM product,
(3) Notify NPMs of their obligations under HRS chapter 675. The Unit accomplished this task by mailing 670 letters to tobacco product manufacturers (worldwide) advising them of the requirements of HRS chapter 675 and related statutes.
(4) Follow through with assistance to effectuate compliance.

How was this accomplished? Armed with a list of wholesalers and distributors the Unit 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

5 HRS chapter 675, §675-1.

6 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.

the wholesalers and distributors. Based on the information contained in the invoices the Unit compiled a list of NPM manufacturers and cigarette brands and being sold in Hawaii. The Unit's list was supplemented by information from Alaska and 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.

Ferreting out individual manufacturers and their respective brands is a time consuming process. Once an NPM is identified as having sales within the State, a notice is sent to the NPM. When an NPM's sales data are accumulated a formal demand is sent to the NPM for each year in which it had sales in Hawaii. One obstacle to enforcement efforts are 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, phone, or by mail order. Retail inspections are the key to uncovering Internet, phone order, or mail order shipments. In conversations with storeowners the Unit has learned of another enforcement barrier: peddlers are offering cigarettes bought at military bases to merchants for resale.[7] These two types of cigarette sales are significant because the NPM sales and untaxed cigarette sales affect the amount of monies 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 other compliant tobacco manufacturers. This price advantage has the potential of luring consumers away, thus affecting the market share of the participating manufacturers. The sale of cigarettes by NPMs is not an academic issue. In the recent disbursement of settlement moneys the states' allocations were reduced due to an 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 seeking compliance with the HRS chapter 675.

MSA Enforcement Activities[8] in Calendar Year 1999

- 1999 NPM sales totaled 3,845,053 cigarettes.

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

8 Diligent enforcement of chapter 675 and the MSA is based upon calendar year end sales of cigarettes. As such, reference is being made to MSA enforcement activities on a calendar year basis.

- In 1999 the Unit identified twenty NPMs who sold cigarettes in the State. Twelve of those NPMs have opened escrow accounts and two have subsequently joined the MSA. HRS chapter 675 requires NPMs selling cigarettes (directly or indirectly) to consumers within the State to either join the MSA or place funds into an escrow account to establish a reserve fund to guarantee a source of compensation to the State in the event of future claims.

- The Unit initiated lawsuits against six NPMs for NPM sales in 1999 seeking compliance with HRS chapter 675.

- Of the six NPMs who are non-compliant, three should have placed amounts in escrow of less than $75.

- While the overall NPM compliance rate for 1999 is 70 percent, the fourteen who have opened escrow accounts represent 96.3 percent of the NPM product sold in the State.

- Star Tobacco, the largest NPM, has funded an escrow account for 1999.

MSA Enforcement Activities in Calendar Year 2000

- 2000 NPM sales totaled 4,944,524 cigarettes.

- The Unit identified twenty-six NPMs who sold cigarettes in the State. Of those twenty-six NPMs, sixteen have opened escrow accounts and one has joined the MSA.

- The Unit initiated lawsuits against eight NPMs for NPM sales in 2000 seeking compliance with HRS chapter 675.

- The Unit is working toward resolution of the issue with one NPM.

- Of the nine NPMs who are non-compliant, five should have placed in escrow amounts of less than $75.

- While the overall compliance rate for 2000 is 65 percent, the seventeen who have opened escrow accounts represent 95.6 percent of the NPM product sold in the State.

- Star Tobacco, the largest NPM, has funded an escrow account for 2000.

MSA Enforcement Activities in Calendar Year 2001

- 2001 NPM sales totaled 8,989,179 cigarettes.

- The Unit identified twenty-three NPMs who sold cigarettes in the State. Of those twenty-three NPMs, sixteen have opened escrow accounts.

- The Unit initiated lawsuits against six NPMs for NPM sales in 2001 seeking compliance with HRS chapter 675. The Unit is accumulating additional data on the remaining NPM in anticipation of litigation.

- Of the seven NPMs who are non-compliant, four should have placed in escrow an amount of less than $75.

- While the overall compliance rate for 2001 is 70 percent, the sixteen NPMs who have opened escrow accounts represent 89.3 percent of the NPM product sold in the State.

- Star Tobacco, the largest NPM, has funded an escrow account for 2001.

MSA Enforcement Activities in Calendar Year 2002

- 2002 NPM sales totaled 11,405,531 cigarettes.

- The Unit identified twenty NPMs who sold cigarettes in the State. Of those twenty NPMs thirteen have opened escrow accounts.

- The Unit initiated lawsuits against four NPMs for NPM sales in 2002 seeking compliance with HRS chapter 675. The Unit is accumulating additional data on the remaining NPMs in anticipation of litigation.

- Of the seven NPMs who are non-compliant, three should have place in escrow an amount of less than $75.

- While the overall compliance rate for 2002 is 65 percent, the thirteen NPMs who have opened escrow accounts represent 88.5 percent of the NPM product sold in the State.

- Star Tobacco, the largest NPM in prior years, had no activity in the State for 2002.

MSA Enforcement Activities in Calendar Year 2003

- Lawsuits were filed against sixteen NPMs for prior years non-compliance with HRS chapter 675. Lawsuits were launched against cigarette manufacturers located in China, Greece, India, and Italy seeking compliance with HRS chapter 675.

- Settlement was reached with one NPM once the State initiated a lawsuit. Settlement discussions continue with other non-compliant NPMs.

- Three non-compliant NPMs joined the MSA.

- Default judgments are being sought as appropriate.

- The Unit is in the process of accumulating data on twenty NPMs.

- 441 notifications are being sent worldwide notifying tobacco manufacturers and others of the certification requirements of Act 77, Session Laws of Hawaii 2003.

- The Unit will be creating a Directory of MSA-compliant cigarettes in accordance with the requirements of Act 77, Session Laws of Hawaii 2003.

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 to S.B. No. 2486, S.D.2, H.D. 2, C.D. 1 (2000)[9] 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"[10].

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

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

[10] 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 unless affixed with the stamp as required by HRS chapter 245.

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 unless affixed with the stamp as required by HRS chapter 245[11]. 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 112 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.

- Over 2,589 inspections have been conducted statewide for tax stamp compliance.

- Inspections have resulted in over 138 felony arrests and the seizure of over 2,200,420 illegal cigarettes.

- "Gray Market" or prohibited export or foreign cigarettes have been identified and in excess of 900 cartons of such cigarettes have been confiscated.

- Criminal fines of $157,392 have been assessed against eighty-five entities (businesses or individuals) for violations of HRS chapter 245.

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

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.[12] 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

[12] 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 $.065/cigarette or $1.30/pack of twenty cigarettes[13]. A counterfeit tax stamp that is offered for sale at a price[14] below the $1.30/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

Investigations[15] 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., $.65 per pack rather than $1.30 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. The Unit will also conduct controlled purchases of cigarettes 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 over the same period in FY 1999-2000. Diligent enforcement yielded an increase of over $22 million or approximately 56 percent:

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13 At present, the states of New York, New Jersey, and Massachusetts have the highest tax rate of $1.50 per pack. Washington has the second highest tax rate at $1.425 per pack. Rhode Island has the third highest tax rate at $1.32 per pack. Michigan has the fourth highest tax rate at $1.25 per pack.

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

15 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.

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 containers[16].

Due to diligent enforcement, cigarette tax revenues for FY 2002-2003[17] increased $7,976,915 million or approximately 12.74 percent over the comparable period in FY 2001-2002. Moreover, vigorous enforcement has significantly contributed to the $30.5 million or approximately 76 percent increase in cigarette tax revenues in FY 2002-2003 over FY 1999-2000:

FY 1999-2000	FY 2002-2003	INCREASE
$40,049,539	$70,586,392	$30,536,853

- 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.

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

17 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.

FY 2002-2003 FUNDING/EXPENDITURES:

Funding for Fiscal Year 2002-2003:

- The 2001 Legislature appropriated moneys for MSA and cigarette tax stamp enforcement. Act 270, Session Laws of Hawaii 2001 (S.B. No. 992), appropriated:

- $350,000 for MSA enforcement and

- $600,000 for cigarette tax stamp enforcement.

Expenditures for Fiscal Year 2002-2003:

- MSA Enforcement: $206,589.89

- Cigarette Tax Stamp Enforcement: $453,688.94

TOBACCO ENFORCEMENT UNIT'S EXPENDITURES FY 2002-2003

		MSA		TAX STAMP
APPROPRIATION		$350,000		$600,000
PERSONNEL COSTS				
SALARIES AND FRINGE	$153,774.42		$383,124.63	
OPERATIONAL EXPENSES & OVERHEAD COSTS				
LEASE RENT	$16,790.54		$16,790.54	
FURNITURE, FIXTURES, & EQUIPMENT	-------		------	
COMPUTERS	-------		------	
TRAVEL	$3,542.15		$23,163.09	
PHONES	$1,454.32		$5,905.14	
OFFICE EQUIPMENT	$1,400.61		$1,400.61	
SUPPLIES	$1,470.91		$1,470.91	
INVESTIGATION EQUIPMENT	--------		$2,439.23	
EVIDENCE STORAGE	--------		$5,886.52	
MILEAGE	--------		$11,086.80	
MISC. EXPENSES	$1,835.03		$2,421.47	
LITIGATION EXPENSES	$26,321.91		------	
TOTAL EXPENSES		($206,589.89)		($453,688.94)
APPROPRIATION BALANCE[18]		$143,410.11		$146,311.06

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 2004 Legislature pass the following measures to assist the Unit with its mission:

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[18] Imbedded in the appropriation balances of $143,410.11 and $146,311.06 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 2002-2003.

- Legislation that addresses the ordering of cigarettes by means of telephone, fax, Internet, or mail order as a means of evading cigarette and use taxes. Criminal sanctions will be sought for these violations.

- 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.