State of Hawaii

Department of the Attorney General

ANNUAL REPORT

OF THE

TOBACCO ENFORCEMENT UNIT

For Fiscal Year 2006-2007

Submitted to
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Regular Session of 2008

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 4
MSA ENFORCEMENT ACTIVITIES IN FISCAL YEAR 2006-2007 6
CIGARETTE TAX STAMP ENFORCEMENT 6
Wholesalers and Distributors 7
Retail Store Inspections and Arrests 8
Coordination with Federal and Other States' Agencies 9
"Gray Market" or Prohibited Export and Foreign Cigarette Contraband ... 9
Counterfeit Tax Stamps 10
Half-Stamping 10
Continuing Enforcement 10
Cigarette Tax Revenues 11
FY 2006-2007 APPROPRIATIONS AND EXPENDITURES: 13
Appropriations for FY 2006-2007: $1,208,149 13
Expenditures for FY 2006-2007: $1,025,910 13
TOBACCO ENFORCEMENT UNIT'S EXPENDITURES FY 2006-2007 14
CONCLUSION 14

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 (hereinafter referred to as "the 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, seven criminal investigators, and an auditor.

In fiscal year (FY) 2006-2007, the State received in excess of $36.8[2] million in MSA settlement moneys. As of the end of June 2007, the State has received in excess of $323 million in MSA settlement moneys. In FY 2006-2007, the Unit received $350,000 in MSA settlement moneys and incurred expenditures of $341,027 in diligently enforcing HRS chapter 675 and the MSA.

Due to diligent enforcement, cigarette tax revenues for FY 2006-2007[3] totaled $88,771,666, which represents an increase of $3,069,183 or approximately 3.58 percent over the comparable period in FY 2005-2006. Moreover, an increase in tax rate coupled with continued vigorous enforcement has significantly contributed to a $48.7 million increase in cigarette tax revenues in FY 2006-2007 over the cigarette tax revenues of $40,049,539 collected in FY 1999-2000. In fiscal year 2006-2007 the Unit incurred expenses of $684,703 in enforcing HRS chapter 245 and related statutes.

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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 MSA payments totaled $36,857,166.01 for fiscal year 2006-2007.

3 Section 245-3(a), Hawaii Revised Statutes, sets forth the cigarette tax rates for the relevant period of this report as follows:

(4) An excise tax equal to 7.00 cents for each cigarette sold, used, or possessed by a wholesaler or dealer after June 30, 2004, whether or not sold at wholesale, or if not sold then at the same rate upon the use by the wholesaler or dealer;

(5) An excise tax equal to 8.00 cents for each cigarette sold, used, or possessed by a wholesaler or dealer on and after September 30, 2006, whether or not sold at wholesale, or if not sold then at the same rate upon the use by the wholesaler or dealer[.]

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
FY 2004-2005	$83,135,360
FY 2005-2006	$85,702,483
FY 2006-2007	$88,771,666

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[4]

MSA Payments include two types of payments:

--Initial Payments: The initial payments were payments to be received annually beginning January 10, 1999[5], through January 10, 2003. The last initial payment was received on January 10, 2003. Total Initial Payments amounted to $65,029,741.67.

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

4 The reporting of the MSA payments in this year's legislative report differs from years prior to FY 2003-2004 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.

--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 2006-2007 was $36,857,166.01[6]. Total Annual Payments received through fiscal year 2006-2007 equal $258,023,920.63.

FISCAL YEAR	AMOUNT OF ANNUAL PAYMENT
1999-2000	$20,811,042.90
2000-2001	$24,471,822.21
2001-2002	$32,674,220.28
2002-2003	$31,845,690.90
2003-2004	$37,793,157.48
2004-2005	$38,357,998.54
2005-2006	$35,212,822.31
2006-2007	$36,857,166.01
Subtotal	$258,023,920.63
Initial Payments	$65,029,741.67
Total MSA Payments	$323,053,662.30

--Total of MSA payments received through fiscal year 2006-2007 is $323,053,662.30.

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,

6 In FY 2006-2007, approximately $4,000,000 in Hawaii's MSA payment was withheld by the tobacco industry due to a dispute over Hawaii's diligent enforcement of chapter 675, HRS, in calendar year 2004. The issue has been ordered to arbitration by Judge Karen Ahn.

short-term profits and then becoming judgment-proof before liability may arise[7].

In FY 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 has been posted on the Internet since October 31, 2003, and has been revised and updated throughout FY 2006-2007. The directory contains information on 43 compliant tobacco product manufacturers and includes a listing of 374 authorized brands of cigarettes and roll your own tobacco products.

Enforcement of the MSA and HRS Chapter 675[8]

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, in FY 2005-2006 the Unit identified eight non-participating manufacturers with sales in the State. 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 products;
(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 products are authorized to be sold in the State.

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7 HRS chapter 675, §675-1.

8 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 have facilitated the Attorney General's on-going diligent enforcement efforts.

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.

Ferreting 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 order[9]. Retail inspections are the key to uncovering Internet, phone order, or mail order shipments. In a prior session, the Legislature enacted, Act 131, Session Laws of Hawaii 2005, which goes into effect December 1, 2006, and requires a retail tobacco permit for the sale of any tobacco products. This law requires the retailer to keep records of all tobacco purchases and is designed to address the problem of cigarettes and other tobacco products being acquired from questionable sources resulting in the evasion of 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.[10] 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.

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9 In the 2005 regular session, the Attorney General testified in favor of legislation (see Act 131, Session Laws of Hawaii 2005) that requires a retail tobacco permit for the retail sale of cigarettes and other tobacco products. Act 131 also requires a retailer to keep adequate records to allow law enforcement to determine the source of all cigarettes and other tobacco products sold at retail.

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

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 2006-2007

- $36,857,166.01 paid to the State under the MSA.

- Seven NPMs sold (whether directly or through a distributor, retailer, or similar intermediary or intermediaries) cigarettes to consumers within the State; six complied with HRS chapter 675; litigation was initiated in FY 2006-2007 against one NPM for sales in 2006 and prior years. In addition, litigation was initiated against four other NPMs, who are not in the Hawaii Tobacco Directory, for sales in prior years. The five lawsuits are pending.

- Pursuant to HRS chapter 675, for 2006 sales six NPMs placed $54,602.26 into qualified escrow funds (99.9% compliance rate).

- Pursuant to HRS chapter 486P, the Attorney General updated the 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 2006-2007 thirty-one participating manufacturers were listed in the tobacco directory.

- At the end of FY 2006-2007 twelve NPMs were 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 unless affixed with the stamp as required by HRS chapter 245[12]. 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 159 felony arrests for tax stamp violations have involved licensed stampers.

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

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.

Retail Store Inspections and Arrests

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

- There are approximately 1,386 known retail establishments[13] that sell tobacco products: 1,034 on Oahu, 147 on Hawaii, 111 on Maui, 9 on Lanai, 13 on Molokai, and 72 on Kauai. Inspections have been conducted on the islands of Kauai, Oahu, Maui, Molokai, Lanai and Hawaii. Felony arrests have been made on the islands of Oahu, Maui, Hawaii, Molokai, and Kauai.

- In FY 2006-2007, 1641 retail checks or HRS chapter 245 compliance inspections were conducted statewide. There were 5 felony arrests for cigarette violations and 7,973 sticks seized.

- Since April 1, 2001, inspections have resulted in over 160 felony arrests and the seizure of over 2,235,073 illegal cigarettes.

- In FY 2006-2007, 2 criminal tobacco prosecutions resulted in $12,000 in fines. In total, the Unit has prosecuted 117 tobacco cases resulting in criminal fines of $180,000. In addition, in FY 2006-2007 TEU prosecutors successfully prosecuted 17 tax cases, which resulted in criminal fines of $136,500 and restitution being ordered in the amount of $158,139 as applicable.

- In total, 50 cigarette prosecutions have resulted in court ordered forfeiture of cigarettes as part of a defendant's criminal sanction. In addition, TEU prosecutors have secured 67 civil administrative forfeiture orders or stipulations to the forfeiture of confiscated cigarettes.

- In FY 2006-2007, TEU prosecutors also secured 15 administrative forfeiture orders for a variety of administrative forfeiture cases from the neighbor islands.

- Beginning December 1, 2006, every retailer engaged in the retail sale of cigarettes and other tobacco products is required to obtain a retail tobacco permit[14]. In addition, every holder of a retail tobacco permit is required to keep a complete and accurate record of the permit holders' cigarette or tobacco product inventory. This requirement is meant as a tool to make sure that all of the tobacco products sold at retail are compliant and that all tobacco taxes are paid. It is interesting to note that for fiscal year 2006-2007, the Department of Taxation reports tobacco taxes from tobacco products other than cigarettes to be $5,587,849, which

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[13] In 2005, the Department of the Attorney General testified in favor of legislation that will require an entity involved in the retail sale of cigarettes or other tobacco products to obtain a retail tobacco permit issued by the Department of Taxation beginning December 1, 2006. Act 131, Session Laws of Hawaii 2005, is intended to provide a mechanism to better identify those entities involved in the retail sale of cigarettes and other tobacco products.

[14] Section 245-2.5, Hawaii Revised Statutes.

represents an increase in taxes of $3,029,716 over the $2,558,133 collected in fiscal year 2005-2006. While there has not been an increase in tax rate[15] for the other tobacco products and in light of the amount of other tobacco product revenues reported in prior years a reasonable inference may be made that the retail permit requirements have had a positive impact on tax revenues.

FISCAL YEAR	TAX FROM OTHER TOBACCO PRODUCTS
2001-2002	$2,898,728
2002-2003	$1,709,547
2003-2004	$1,842,697
2005-2006	$2,558,133
2006-2007	$5,587,849

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, Firearms, and Explosives of the Department of Justice, 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.[16] 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. Postal Service, Federal Bureau of Alcohol, Tobacco, Firearms, and Explosives of the Department of

[15] Section 245-3, Hawaii Revised Statutes, provides for an excise tax equal to forty percent of the wholesale price of each article or item of tobacco products sold by the wholesaler or dealer.

[16] In 2001, 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.

Justice, Internal Revenue Service, U.S. Customs and Border Protection of the Department of Homeland Security, 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 and Border Protection of the Department of Homeland Security 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 ninth highest in the nation at $.09/cigarette or $1.80/pack of twenty cigarettes[17]. A counterfeit tax stamp that is offered for sale at a price[18] below the $1.80/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[19] 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., $.90 per pack rather than $1.80 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. Efforts continue

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17 As of July 1, 2007, the Campaign for Tobacco Free Kids reports that the State of New Jersey Island has the highest tax rate of $2.58 per pack. Rhode Island is second with a tax rate of $2.46 per pack. Washington State's tax rate is third at $2.25. Alaska, Arizona, Connecticut, Maine, and Michigan are fourth with tax rates of $2.00 per pack. Hawaii will be ranked 9th effective 9/30/07 with an effective tax rate of $.09 per stick or $1.80 per pack.

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

19 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.

both in Hawaii and on the national stage to address the problems posed by the Internet sale of cigarettes. Hawaii continues to cooperate with other states in facilitating the agreements reached between the states and the major credit card companies that prohibit the use of credit cards in the purchase of cigarettes by way of the Internet and through the mail.

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:

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[20].

Due to diligent enforcement, cigarette tax revenues for FY 2006-2007[21] totaled $88,771,666, which represents an increase in revenue of $3,069,183 or approximately 3.58% percent over the comparable period in FY 2005-2006[22]. Moreover, an increase in tax rate coupled with continued vigorous enforcement has significantly contributed to a $48.7 million increase in cigarette tax revenues in FY 2006-2007 over the cigarette tax revenues of $40,049,539 collected in FY 1999-2000.

[20] Each forty-foot container holds 960 master cases containing 50 cartons each.

[21] The cigarette tax rate of $.07 per stick ($1.40 per pack), which became effective on July 1, 2004, increased to $.08 per stick ($1.60 per pack) on September 30, 2006.

[22] Cigarette tax revenue for FY 2005-2006 stood at $85,702,483.

FY 1999-2000	FY 2006-2007	INCREASE
$40,049,539	$88,771,666	$48,722,127

- 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.

FUNDING FOR FY 2006-2007

TOTAL FUNDING: $1,748,923.65

MSA ENFORCEMENT FUNDS: $350,000

CIGARETTE TAX STAMP FEES/INT./FINES: $1,398,923.65

FY 2006-2007 APPROPRIATIONS AND EXPENDITURES:

Appropriations for FY 2006-2007: $1,208,149

- The Legislature appropriated $1,208,149 for MSA and cigarette tax stamp enforcement for FY 2006-2007.

- **$350,000** for MSA enforcement and

- **$858,149** for cigarette tax stamp enforcement.

- An additional **$130,953** was appropriated by way of Act 131 Session Laws of Hawaii, Twenty-third State Legislature, Regular Session 2005, to the Department of Taxation for the purpose of establishing and administering the Retail Tobacco Permit program. The funds were earmarked to establish three permanent full-time equivalent positions, and for other expenses incurred by the Department of Taxation in order to carry out the purpose of Act 131.

Expenditures for FY 2006-2007: $1,025,910

- **MSA Enforcement: $341,207**

- **Cigarette Tax Stamp Enforcement: $684,703**

TOBACCO ENFORCEMENT UNIT'S EXPENDITURES FY 2006-2007

	MSA		TAX STAMP	
APPROPRIATION		$350,000		$858,149
PERSONNEL COSTS				
SALARIES AND FRINGE	$266,108.22		$516,250.65	
OPERATIONAL EXPENSES & OVERHEAD COSTS				
LEASE RENT	$33,842.14		$33,842.14	
FURNITURE, FIXTURES, & EQUIPMENT	-------		------	
COMPUTERS	-------		------	
TRAVEL	$2,411.80		$19,026.71	
PHONES	$2,658.83		$6,511.76	
OFFICE EQUIPMENT	$3,428.27		$3,428.27	
SUPPLIES	$2,259.11		$3,750.77	
INVESTIGATION EQUIPMENT	--------		------	
TRAINING/CONFERENCE	------		------	
EVIDENCE STORAGE	--------		--------	
MILEAGE	--------		$11,871.19	
MISC. EXPENSES	$999.40		$1,508.15	
LITIGATION EXPENSES			$16.87	
ADMINISTRATION EXPENSES (EST. ALLOCATION)	$29,498.92		$88,496.78	
TOTAL EXPENSES		($341,207)		($684,703.)
APPROPRIATION BALANCE[23]		$8,793		$173,445.

CONCLUSION

The unit's activities are critical and time-sensitive if the State is to receive its fair share of the "Tobacco Settlement Funds" as a result of diligent enforcement of the MSA, HRS chapter 675, and related statutes.

Effective enforcement of the State's Gray Market Statute, Cigarette Tax Stamp requirements, Tobacco Permit requirements, and a comprehensive regulatory environment will allow the Unit to identify and address any problems that the State may have with contraband cigarette sales and increase State tax revenues by providing a more effective means to assess, collect, and enforce the provisions of HRS chapter 245 and related statutes.

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[23] Imbedded in the appropriation balances of $182,238 are personnel costs that were not incurred due to positions not being filled for the entire fiscal year (2 Investigartor V positions and 1 Auditor position are to be filled). As a result, funds that would otherwise have been used for these positions' salaries and fringe benefits reverted to the Tobacco Enforcement Special Fund.