

Cigarette smuggling cuts states' per-pack tax revenues

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May 31--Over the past decade, almost every state has raised cigarette taxes, sometimes multiple times. The health benefits are undeniable, but the benefits to states' revenues are not as clear-cut.

In 2010, states with high tobacco taxes lost about \$5 billion in revenue because of cigarette smuggling, according to the Bureau of Alcohol Tobacco Firearms and Explosives. Experts say the number is climbing.

Most of the black market in cigarettes is between low-tax states and high-tax states: Smugglers purchase cigarettes in a low-tax state and transport them to a high-tax state. Then they sell them at a discount to smokers while still pocketing a healthy profit. Because there is such a wide disparity among states' cigarette taxes, the price differential is well worth the risk of smuggling, according to law enforcement officials.

Minnesota is the latest state to hike cigarette taxes. The legislature this year more than doubled the tax -- from \$1.23 a pack to \$2.83. Massachusetts is also in the throes of debating a cigarette tax hike that would increase state taxes by another dollar, to \$3.51 a pack.

The Federation of Tax Administrators, which keeps track of taxes in the 50 states, says all but three states -- California, Missouri, and North Dakota -- have raised their cigarette taxes at least once since 2000. These taxes vary widely, from a low of \$0.17 in Missouri to a high of \$4.35 in New York.

On top of the state tax, New York City levies its own tax of \$1.50 per pack--making the city an attractive destination for smugglers.

"In the past few years, as taxes have gone up, you do notice it (the increase in smuggling)," said Charles Mulham, special ATF agent and public information officer in the New York office.

Mulham said smugglers usually drive down the eastern seaboard to Virginia, which has the second lowest tax in the country at 30 cents a pack, and pay \$15 to \$20 a carton. They load up a U-Haul and return to New York City where cartons normally sell for \$120 each.

The smugglers sell them there for \$60 to \$70 a carton -- half price to the smokers and without the tax collected. If they take apart the cartons and sell the contraband by the pack, the profit is even greater in a city where a pack goes for about \$12, he said.

Geoff Gloak, spokesman for the New York State Department of Taxation and Finance, said that New York State cigarette tax collections have been steadily increasing the last several years, to \$1.5 billion in 2012. He did not have an estimate on the revenue lost to the state through smuggling, but noted that enforcement efforts have picked up.

Others, however, estimate New York's loss to be significant. According to a study by the Michigan-based Mackinac Institute for Public Policy, which studies cigarette smuggling, an estimated 60 percent of the cigarettes consumed in New York were smuggled illegally into the state, avoiding taxes. Michael LaFaive of the center estimated that the state could have lost as much as \$1.8 billion in 2011 as a result.

Part of the reason smuggling is so lucrative is that the "price of doing business" for the smugglers is low. Current penalties in New York are about \$150 a carton if smugglers are caught. In June, the penalty is scheduled to go up to \$600 a carton, under a bill signed into law by Gov. Andrew Cuomo.

In a 2008 study called "How Far to the Border," Stanford University professor Michael Lovenheim estimated that 13 percent to 25 percent of cigarette consumers bought their cigarettes in a cheaper jurisdiction than where they live. These smokers seek out "border localities" with lower taxes, such as other states, other countries or Indian reservations.

Prosecution of such "casual" smugglers is more difficult than tracking the big guys. The number of casual smugglers increases with the amount of tax in the smuggler's home jurisdiction and the proximity of a cheaper locale, he found.

Lovenheim estimated that 31 percent of smokers in New Jersey, which has a \$2.70 a pack cigarette tax, engage in "casual smuggling," while only .01 percent of smokers do so in California, where the tax is 87 cents. Maryland and the District of Columbia came in at 36 percent and a whopping 63 percent, respectively, mostly because of their proximity low-tax Virginia -- which, in many cases, is just over a bridge. Cigarette smuggling is so profitable that it is even allegedly being used to fund terrorists. In mid-May, 16 Palestinian men, some whom authorities said had ties to terrorists, were arrested in what police said was a \$55 million illegal cigarette smuggling scheme that spanned New York, Maryland, Delaware, Virginia and New Jersey.

Ray Kelly, New York City Police Commissioner, said the smuggling was discovered while the men were under surveillance for alleged

terrorism ties. "We discovered that individuals who were on our radar for links to known terrorists were engaged in a massive raid on the New York Treasury in the form of cigarette tax avoidance," Kelly said at the time.

In Minnesota, the \$1.60 cigarette tax increase that will go into effect July 1 has been hailed as a way to raise funds for a new stadium for the popular Minnesota Vikings football team, among other things. But Democratic Gov. Mark Dayton said the tax is also about health.

"I believe we want to make taxes fairer not more regressive, but it serves other purposes," Dayton told Minnesota Public Radio. Estimates were that the new tax would raise \$365 million for the state over two years.

Mackinac's LaFaive says the state shouldn't celebrate yet. He points to Michigan, which has a \$2 a pack cigarette tax, 11th highest in the country, where smuggling was rampant after the taxes went up in the early 2000s. "Michigan saw a big spike in its smuggling," he said. "The tax went from 25 cents to 75 (at that time) cents a pack. The state of Michigan quickly learned they needed to impose a tax stamp on the cigarettes because of the massive smuggling."

As for Massachusetts, where the issue is currently under debate, the Mackinac Institute wrote a letter to the legislature in an attempt to point out what could be the unintended consequences of upping the cigarette tax, calling it a "lose-lose" proposition. In the letter, the Mackinac officials said that about 18 percent of the cigarettes consumed in Massachusetts are smuggled. With the tax hike, the institute predicted that would rise to 44 percent, rivaling New York. Massachusetts is expected to make a decision on the cigarette tax by mid-summer.

"Overall, despite the tax rate increase, the state will experience such an increase in smuggling that tobacco tax revenues are projected to fall by just over 3 percent," they wrote.

HIGHEST AND LOWEST CIGARETTE TAX STATES

Highest

New York State \$4.35 (add'l \$1.50 in New York City)

Rhode Island, \$3.50

Connecticut, \$3.40

Hawaii, \$3.20

Washington, \$3.02

Lowest

Missouri, \$.17

Virginia, \$.30

Louisiana, \$.36

Georgia, \$.37

Alabama, \$.42

Source: The Federation of Tax Administrators

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