



Improving Cigarette License and Tax Administration

*Coordinating New York State and New York City Activities
Can Prevent Illegal Sales and Lead to Increased Revenues*

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Office of the State Comptroller
Alan G. Hevesi

Deputy Comptroller Margaret M. Sherman
Office of Budget and Policy Analysis
Albany, New York 12236

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Executive Summary

Cigarette excise taxes and license fees are an important source of revenue for both New York State and New York City. In recent years, cigarette taxes have been increased a number of times to provide greater public support to a wide range of health care programs and as a way to decrease smoking. Both State and City agencies enforce New York's cigarette licensing and tax laws, so it is important that these agencies appropriately coordinate activities to ensure that cigarette vendors are properly licensed and that cigarette taxes are collected in the most efficient and effective manner possible.

The Office of the State Comptroller has recently issued two audits of the State and City agencies involved in the administration of cigarette tax law enforcement. The first is an audit of the New York State Department of Taxation and Finance entitled *Selected Controls over Cigarette Licensing and Excise Taxes* (Report 2002-S-58), released in October 2003. The second is an audit of the New York City Departments of Consumer Affairs and City Finance, which was released in July 2004, entitled *Selected Controls over Licensing of Cigarette Retailers and Wholesalers* (Report 2003-N-7). Although these two audits were conducted independently, both reviewed controls over vendor licensing and enforcement associated with the sale of cigarettes.

The purpose of this report is to review the findings of both audits and raise additional issues for consideration to improve the coordination of the cigarette vendor licensing and enforcement processes between the New York State and New York City agencies. In turn, better coordination and enforcement could result in increased revenue collections and decreased illegal sale of cigarettes.

Improvements in cigarette enforcement have been shown to yield positive results. In 2002, the Department of Taxation and Finance (Tax and Finance) expanded their enforcement efforts in response to the cigarette excise tax increase that year through enactment of legislation to increase the number of Tax and Finance enforcement investigators to 89. This action was successful in increasing the volume of untaxed cigarettes that were seized in the following period from 17,000 cartons to nearly 215,000 cartons. The State, City and other localities would have lost a total of nearly \$7 million in revenues had these cigarettes been sold illegally.

New York State and New York City have each raised cigarette excise taxes significantly over the last several years, most recently in 2002. Combined State taxes and licensing fees collected from cigarettes totaled more than \$1.1 billion in State fiscal year 2003-04. The City's tax and license fee collections were approximately \$170 million in City fiscal year 2002-03, the most recent year figures are available. There has also been substantial cigarette-related regulatory activity during this period, resulting most recently in a statewide ban on smoking in the workplace, including restaurants

and bars. This regulatory and tax activity has come after decades of health concerns expressed about tobacco and only after a long and contentious public debate. These overlapping concerns have produced an unusual collaboration between public health and tax policy in which New York State and New York City have tried to augment revenues through this "sin tax." Through education and advocacy, public health advocates have made significant inroads, so that tax policy and public health policy are now moving in the same direction.

Like most states, New York has long recognized the negative health consequences of smoking. In 2002, about 22 percent of the State's adult population, 3.1 million people, smoked cigarettes. People who use tobacco often suffer from chronic medical illnesses and a shortened lifespan of about 13.7 years, on average. In 1999, the most recent period for which data is available, tobacco use in the State resulted in associated medical costs of more than \$6.4 billion and more than 24,500 deaths. However, New York's recent regulatory and tax initiatives may be having some positive effects. A recent survey by the New York City Department of Health and Mental Hygiene reported an 11 percent decrease in the number of smokers from 2002 to 2003, attributed in part to the increase in cigarette excise taxes and public education on the health risks of tobacco use.

Although regulatory and tax policies may already be having a positive effect on the State's population, there is room for improvement. The audits conducted by the Office of the State Comptroller found that, despite the dedication of significant resources to the enforcement of State and City Tax Laws, there are a number of areas where serious enforcement problems exist:

- A sample survey of 81 retailers conducted by auditors found that 21 retailers (26 percent) were selling cigarettes without the requisite excise tax stamps. Four of these illegal retailers were selling cigarettes in New York City with State-only stamps, resulting in a loss of City excise tax revenue, and one retailer was selling cigarettes without any tax stamp at all. These results suggest that aggressively investigating retailers with lapsed licenses would identify a significant number of Tax Law violations.
- Nearly one year after the April 2002 increase in the State cigarette excise tax, Tax and Finance had still not complied with its procedures to follow up and determine whether cigarette vendors had submitted the correct amount of sales tax owed through the increased liability of this "floor tax." Of vendors sampled, the audit found that 153 (48 percent) had underpaid the State nearly \$613,000 due to improper filing or follow up.
- Cigarette tax stamps may not be properly protected or accounted for with current procedures in place. Meyercord, Inc., an Illinois company, manufactures these stamps under contract with New York and ships them to various sites within the State maintained by another State contractor. The

audit found that Tax and Finance lacked formal, written procedures for safeguarding the production, distribution and storage of stamp inventories.

- Cigarette vendor license data stored on information systems maintained by the New York City Departments of Consumer Affairs (Consumer Affairs) and Finance (City Finance) was found to conflict with license data maintained by the Department of Tax and Finance due to different data collection and storage practices. Auditors comparing Tax and Finance and Consumer Affairs cigarette retailer records identified 3,583 retailers with valid State licenses, but no current City license. Auditors projected that between 285 (8 percent) and 725 (20 percent) of these retailers were selling cigarettes without a current City license. The auditors attributed this in part to the failure of the State and City to compare records to ensure that retailers have the required State license before applying for a City license and that the information for all retailers is correctly entered in each database.
- A review of State and City records for cigarette wholesalers found both wholesalers with a valid City license and no State license, and wholesalers with a valid State license, but an expired City license. While the City did follow up on the identified wholesaler licensure violations, the audit determined that it has no formal written procedures for the wholesale license review and approval process, nor a formal, long-term strategic plan for the enforcement of the cigarette licensing laws.

Agency officials at the State and City government have embraced the Comptroller's audit recommendations in the following areas: developing formal procedures to enhance enforcement activities, improving coordination among agencies to facilitate the identification of unlicensed cigarette vendors and performing follow up activities on vendors identified by the audit team as not in compliance with cigarette licensing laws. The agencies should be commended for working to quickly implement the recommendations.

The record-keeping inefficiencies identified in the audits may have a significant impact on State and City revenues. Between 1994 and 2003, the State collected over \$7.7 billion in cigarette excise taxes and an additional \$223 million in other tobacco revenues. In New York City, cigarette excise tax revenues totaled \$454 million during the same period. Currently, 61 percent of State excise taxes and 46 percent of City excise tax collections are dedicated to support Health Care Reform Act activities and initiatives.

Consideration of the audits together shows that opportunities exist to improve cigarette revenue collection and reduce illegal sales of cigarettes through better coordination of State and City cigarette vendor licensing procedures and enforcement activities, including the following:

- Currently, there is little coordination of State and City licensing efforts. Although more than half of the retailers and wholesalers in the State are located in New York City, there currently is no single mechanism during the licensing process to ensure that cigarette retailers and wholesalers are lawfully licensed by both the State and City.
- Data elements that should be common in both State and City licensing records are not used, making data sharing between agencies impossible. Without such common elements, it is impossible to track or identify cigarette vendor data between the State and City.
- State and City cigarette vendor license periods are of different durations. The State wholesaler license is valid for an indefinite period, while the City wholesaler license is valid for one year. The State and City retailer license periods also differ, with the State license good for one year and the City license renewed on a biennial basis. The infrequent renewal requirements and varying periods of vendor licensure currently make this verification cumbersome for the vendors, as well as for the State and City

Enforcement and inspection activities are also a matter of concern. Similar to licensing, there is little coordination of State and City cigarette enforcement operations. Efforts should be made to better communicate and coordinate enforcement planning so that resources can be allocated more efficiently and reduce any duplication of effort. In particular:

- Lack of common computer-based data elements makes greater use of shared information resources impossible. This, in turn, has prevented a more sophisticated and coordinated approach to tax enforcement, allowing enforcement review data on specific vendors that is captured by one agency to be leveraged by the other.
- Shared information—currently lacking—might also allow State and City enforcement officials to track down illegal wholesale activities. For example, current State law and City code do not require that enforcement officials be notified when retailers discover improperly stamped cigarettes; retailers are only required to notify their wholesalers when they find such cigarettes. This means that there is nothing to prevent unscrupulous wholesalers from selling improperly stamped cigarettes somewhere else. Tax and Finance and Consumer Affairs should work together to develop legislation that would require a retailer identifying improperly stamped cigarettes to notify the State and City officials.

This report incorporates the recommendations of both Office of the State Comptroller audits. The following recommendations result from a combined review of both audits, and should be considered to improve the coordination of cigarette licensing

and enforcement activities. Appropriate evaluation and implementation of these proposals by Tax and Finance, Consumer Affairs and City Finance can also yield significant improvements in enforcement results, increasing State and City cigarette revenues and preventing the illegal sale of cigarettes in New York State.

1. Tax and Finance, Consumer Affairs and City Finance should evaluate the cost/benefits of a joint State/City license application process for cigarette wholesalers and a joint State/City license application process for cigarette retailers. As part of this evaluation, the State and City agencies should:
 - consider coordinating State and City cigarette vendor license periods,
 - identify and implement common data elements that would facilitate the State and City agencies' licensing and enforcement of New York City cigarette vendors,
 - consider implementing a mechanism that would automatically identify vendors who have not renewed their licenses at the end of established license periods,
 - consider developing a joint State/City web-based license status listing for use by cigarette vendors, as well as by the State and City agencies, as a way to help restrict cigarette sales to appropriately licensed vendors (such a listing would differentiate New York City-only vendors),
 - consider application forms that build on the best practices of the current application forms of each agency,
 - consider whether the joint State/City license application processes should be implemented on an incremental basis, and
 - work with the Legislature to enact any statutory changes needed to implement these recommendations.

After careful consideration of these proposals, should the State and City agencies determine that the benefits of such a process would not offset the effort or cost, it would be appropriate to give separate consideration to each proposal noted above.

2. Tax and Finance, Consumer Affairs and City Finance should consider coordinating inspection and enforcement planning and reporting resources to allow increased compliance and operational review of cigarette vendors, improve focus on areas currently receiving less attention and help prevent duplication of effort.

3. Tax and Finance, Consumer Affairs and City Finance should work together to identify and evaluate stronger linkages between their information systems, such as allowing the transfer of vendor data among agencies to enhance current enforcement practices, to decrease the unlawful sale of cigarettes and to improve revenue collections.
4. Tax and Finance and Consumer Affairs should work together with the Legislature to amend the State Tax Law to require State and/or City notification by retailers when improperly stamped cigarettes are discovered after purchase from wholesalers, allowing additional enforcement efforts of these high-risk vendors.

Introduction

Cigarettes and tobacco products have been taxed in New York State under Article 20 of the New York State Tax Law since 1939.¹ Combined State sales tax, excise tax and license fees collected from the sale of cigarettes and other tobacco products are estimated to have totaled more than \$1.1 billion dollars in State fiscal year 2003-04. New York City began taxing cigarettes and tobacco products in 1952. The City's tax and license fee collections were at least \$170 million in City fiscal year 2002-03. An additional City license is required for the sale of cigarettes, but not tobacco products.²

Cigarette taxes are ultimately passed through to the cigarette consumer, including excise taxes on each pack of cigarettes. Currently, the State and City each levy an excise tax of \$1.50 per pack for a total of \$3.00. Sales tax is also levied by the State, as well as the locality in which the sale takes place, based on the retail sales price of the cigarettes. The State sales tax is 4.25 percent, while localities charge about 4 percent sales tax, adding approximately 8.25 percent to the cost of each pack of cigarettes.

Cigarette vendors include distributors, agents, wholesalers and retailers and are generally required to be registered or licensed by the State. New York requires agents, wholesalers and retailers to be licensed and pay an associated license fee. New York City requires only wholesalers and retailers to be licensed and pay a City license fee.

Due to the relatively small size of cigarette packages and their easy availability from a number of manufacturers and distributors, cigarettes and other tobacco products can easily be brought into New York without the payment of State taxes. In order to prove that the appropriate excise taxes have been paid, the Tax Law requires the purchase of an adhesive stamp that is attached directly to each cigarette pack when it is initially imported into the State or the presentation of an invoice for tobacco products showing that the tax has been paid.

The Office of the State Comptroller recently completed two audits entitled *New York State Department of Taxation and Finance: Selected Controls over Cigarette Licensing and Excise Taxes* (Report 2002-S-58) and *New York City Department of Consumer Affairs and New York City Department of Finance: Selected Controls over Licensing of Cigarette Retailers and Wholesalers* (Report 2003-N-7). These audits reviewed the operations of agencies charged with the collection of taxes and fees related to tobacco products and the enforcement of other provisions of the Tax Law.

¹ Article 20, Section 470 of the New York State Tax Law defines cigarettes as "any roll for smoking made wholly or in part of tobacco or any other substance... the wrapper or cover of which is made of paper or any other substance or material, except tobacco." Tobacco products are defined as "any cigar or roll for smoking, other than a cigarette, made in whole or part of tobacco, and any tobacco other than cigarettes, intended for consumption by smoking, chewing, or as snuff."

² New York City Administrative Code, Section 11-1302 (2001).

The audits assess three major issues: 1) whether the State's Department of Taxation and Finance (Tax and Finance) maintains adequate internal controls over cigarette licensing and excise tax revenue, 2) whether the City's Department of Consumer Affairs (Consumer Affairs) and Department of Finance (City Finance) maintain accurate licensing data for cigarette retailers and wholesalers, and 3) whether the State and City agencies are able to ensure that retailers and wholesalers with expired, suspended or revoked licenses are no longer selling cigarettes.

The audits found a number of breakdowns in coordination or communication among the State and City agencies responsible for tobacco tax administration. Because of these lapses, illegal cigarette sales continued when they could have been stopped.

The purpose of this report is to bring together the findings of the State and City audits, considering tobacco tax administration and the related licensing and enforcement activities from a broader context. The recommendations made in the audits will enhance the agencies' operations, and Tax and Finance, Consumer Affairs and City Finance should be commended for agreeing with and quickly working to implement the audit's recommendations. This report highlights several additional opportunities associated with coordinating State and City processes that should be carefully evaluated. Better coordination among the State and City will improve licensing and enforcement activities and maximize both State and City revenues, as well.

Tobacco Distribution and Taxes in New York State

The administration of the State Tax Law related to tobacco and the collection of cigarette and tobacco tax revenues is assigned to the State Commissioner of Tax and Finance. In the City of New York, Consumer Affairs and City Finance share this responsibility with the State. This dual level of regulation does not exist outside New York City, nor does it seem to appear in other states. A brief review of the tobacco product distribution system and the types of taxes and fees levied by these agencies will help put the audits into context.

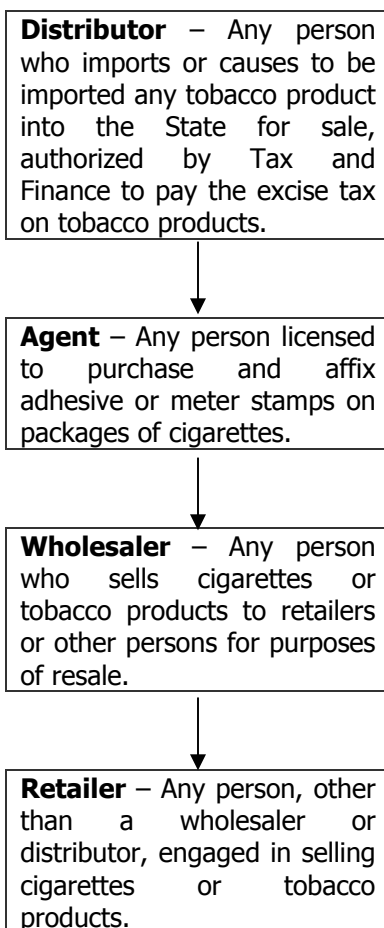
The Tobacco Distribution System

Cigarettes and other tobacco products come into the State under the control of a distributor and then pass to wholesalers who purchase and maintain stock from multiple distributors. Wholesalers in turn provide a variety of products and brands to multiple retailers who sell products directly to consumers. Since cigarette packs must have an excise tax stamp affixed to them to indicate that the appropriate excise tax has been paid, an agent is licensed to purchase the stamps and attach them to cigarette packs. This occurs while the cigarettes are in the possession of a distributor or wholesaler, but prior to delivery to a retailer. It is possible for a single vendor to perform more than one of these roles, but if he or she does so, separate licenses are required for each step in the distribution process. Article 20 of the State Tax Law contains provisions detailing definitions and procedures over the Tobacco Distribution System.

Distributors are associated with the initial purchase of tobacco products and are required to register with Tax and Finance, but do not have to obtain a license. A manufacturer can be its own distributor or it can supply independent distributors. Distributors are liable for the payment of excise taxes on tobacco products that they import or have imported into the State, and they must file a tax return with Tax and Finance accompanied by the appropriate excise taxes within 24 hours of the importation of tobacco products into New York State.

An **agent** is an entity that is licensed by Tax and Finance to procure and affix New York State and/or New York City tax stamps to all cigarette packs before they can be sold at wholesale or retail. An agent may also be a wholesaler or a distributor, but need not be one. The agent purchases these stamps from a Tax and Finance approved source, affixes them to the cigarette packs, and then adds the actual cost of the stamps to the wholesale price when possession of the cigarettes is transferred to the wholesaler or retailer. The agent is authorized to retain a commission in exchange for

providing this service, not to exceed 5 percent of the actual cost of the stamps.³ Agents can only provide stamps to wholesalers or retailers who have current New York State licenses (and New York City licenses if the product is intended for resale there) to sell cigarettes or tobacco products.



Agent and wholesaler State licenses currently cost \$1,500, regardless of the number of business locations these vendors maintain. State agent licenses are valid for a minimum of three years, while State wholesaler licenses are valid indefinitely.⁴ Licenses are renewed periodically at the discretion of the Commissioner, but not more often than once every three years.⁵ All New York State agents were required to obtain new licenses in 2002, but prior to that the last general re-licensing occurred in 1988.

³ Section 472 of the New York State Tax Law states "The Commissioner is hereby authorized to prescribe a schedule of commissions, not exceeding five percentum, allowable to such agent for buying and affixing such stamps."

⁴ Section 480 of the New York State Tax Law includes the following acts as cause for revocation or suspension: failure to maintain a required bond, failure to comply with any of the provisions of the Tax Law, knowingly aiding another person in the violation of Tax Law, fraudulently obtaining a license, conviction of a felony and knowingly selling tobacco products to an individual who is not properly licensed.

⁵ Section 480 of the New York State Tax Law.

There were approximately 100 agents licensed by Tax and Finance to affix tax stamps to cigarettes for sale in New York State.

By law, agents can only sell cigarettes or other tobacco products to wholesalers and retailers who have valid licenses for New York State (and New York City, if the product is intended for resale in that locality). During procurement, agents are required to document the source and product purchase price. Similarly, when selling cigarettes, agents are required to record the customer name and sale price. These records have to be retained for three years and must be presented to Tax and Finance officials upon demand.

Wholesalers are entities that sell cigarettes or other tobacco products to retailers for the purpose of resale. In 2003, there were approximately 300 wholesalers in New York State. All excise taxes that have been imposed by New York State and New York City have to be paid on cigarettes and other tobacco products that are in the possession of wholesalers before they can be resold to retailers. As with agents, wholesalers are only allowed to sell tobacco products to other licensed wholesalers and retailers and must document all tobacco transactions. Wholesalers must maintain documentation of purchases and sales for three years.

Prior to obtaining a State license, prospective wholesalers must meet several requirements. These requirements include proof of United States citizenship or eligibility to obtain employment if not a citizen, a net worth of at least \$25,000, and proof that a separate and secure warehouse facility will be maintained for the purpose of receiving and distributing cigarettes and tobacco products.

New York City requires that cigarette wholesalers have a valid City license, in addition to a valid State license. The New York City Wholesale Cigarette License costs \$600 annually, and there were approximately 160 wholesalers licensed by City Finance in 2003.

State Tax Law defines **retailers** as any entity, other than a wholesaler, who engages in the sale of cigarettes or tobacco products. Retailers must purchase cigarette products only from agents or wholesalers with a current State license and maintain documentation on all purchases for a period of three years.

Upon delivery of cigarettes from an agent or wholesaler, a retailer must mark the cigarette shipping container with his or her signature and date of receipt. The container must then be opened within 24 hours of receipt, and the individual packages must be checked to make sure that the proper excise tax stamps are affixed. If the proper stamps are not affixed, it is the responsibility of the retailer to notify the appropriate agent or wholesaler that the product is improperly stamped and return the product to the wholesaler. The sale of improperly stamped cigarettes by retailers is a violation of State Law and can result in fines and/or criminal penalties.

Retailers are required to obtain a State Certificate of Registration—the legal name of the license—from Tax and Finance annually for each place of business from which they sell cigarettes or other tobacco products. Licensed retailers must file a license renewal application, along with their sales tax return, by the end of August of each year. The State cigarette retailer Certificate of Registration (hereafter referred to as license) costs \$100 for each retail location and \$25 for each tobacco vending machine. In 2003, there were approximately 25,000 individual retail locations with a license authorized to operate in New York State.

In addition to holding a valid State license, New York City requires retailers to obtain a New York City Retail Cigarette License costing \$110, biennially, for each cigarette retail location. In 2003, there were approximately 12,300 individual retail locations authorized to sell cigarettes in the City.

New York State and New York City Cigarette Vendor Licenses

License Type	New York State	New York City
Distributor	Registration Rather Than License	
Cost	None	NA
Agent		
Cost	\$1,500	NA
Term	Not less than 3 years	NA
Approx. # in 2003	100	NA
Wholesaler		
Cost	\$1,500	\$600
Term	Indefinite	Annually
Approx. # in 2003	300	160
Additional Requirements		Valid NYS License
Retailer		
Cost	\$100	\$110
Term	Annually	Biennially
Approx. # in 2003	25,000	12,300
Additional Requirements		Valid NYS License

Cigarette and Tobacco Taxes and Fees

There are three types of taxes and fees levied on cigarettes and other tobacco products: 1) cigarette vendor license fees, 2) excise taxes based on the number of cigarettes in a pack or the wholesale value of tobacco products, other than cigarettes, and 3) sales taxes levied on the final consumer sale price of cigarettes and other tobacco products.

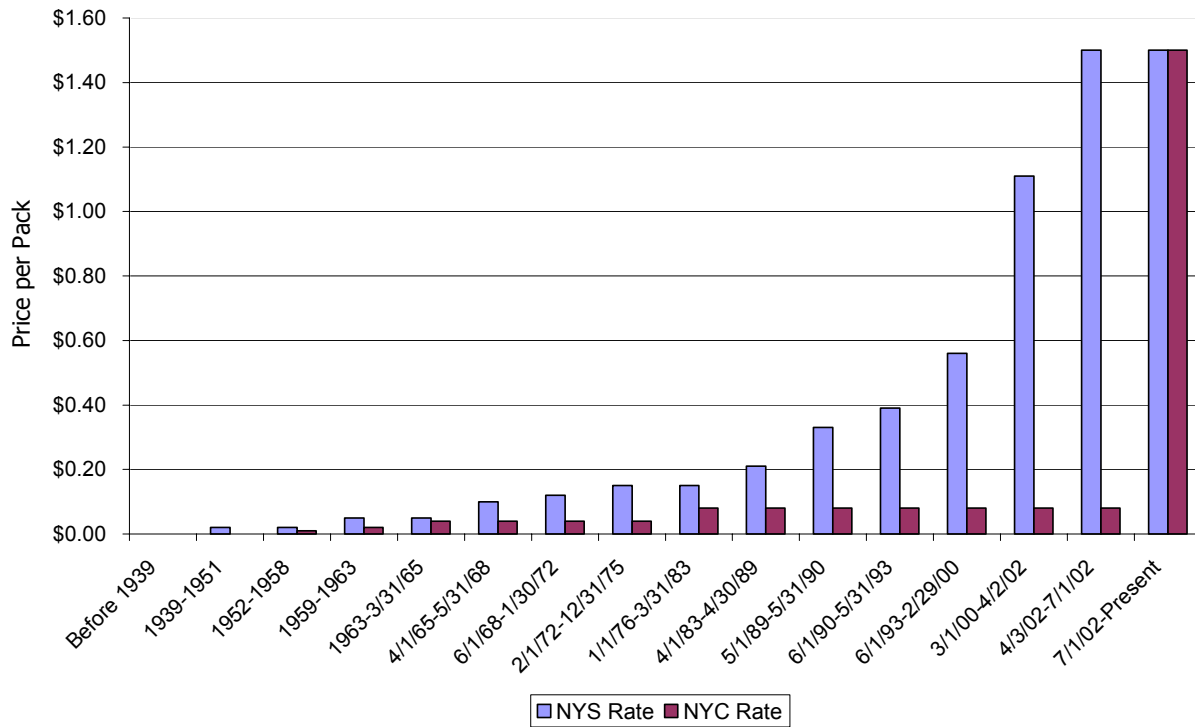
License fees are established in State Tax Law and licenses must be purchased by all cigarette vendors before engaging in the wholesale or retail sale of cigarettes or other tobacco products. Under State law, the delivery of cigarettes and other tobacco products to the consumer requires going through three distinct distribution steps involving an agent, a wholesaler and a retailer, each requiring a State license.

An **excise tax** is generally a revenue raising action that is based on the units of a product, rather than the product's sales price. Anyone who is in possession of cigarettes or other tobacco products can be required to show proof that the appropriate excise taxes have been paid. The initial purchaser pays the excise tax and is allowed to recoup the amount of the tax from the next buyer in the distribution chain so, as a result, the tax is ultimately passed on to the consumer. Currently, the New York State and New York City cigarette excise tax is \$1.50 each per pack for a total of \$3.00 for each pack of cigarettes purchased.

The liability for excise taxes is created when cigarettes or other tobacco products enter the State, and a tax return indicating the amount due must be submitted to Tax and Finance, along with payment within 24 hours. The attachment of a tax stamp is considered evidence that the excise tax has been paid on cigarettes, while other tobacco products must be accompanied by an invoice indicating payment to Tax and Finance.

Excise taxes are applied to cigarettes based on the number of cigarettes in a pack. However, in the case of tobacco products that do not come in packs, such as snuff or chewing tobacco, the excise tax is based on the wholesale price. The agent initially pays the excise tax on cigarettes by purchasing an excise tax stamp, which is attached to the cigarette packs. In order to keep City wholesalers and retailers from having to affix both a City and a State tax stamp to each pack of cigarettes, there is a joint State/City stamp available to agents. This stamp is available at a cost equal to the sum of the State and City excise tax rates and must be used on all cigarettes sold within the City. The State, City and joint State/City excise tax stamps are color coded.

Cigarette Excise Tax Rates (1939 to 2004)



When the State and City excise tax on cigarettes increased in 2002, it was necessary for agents, wholesalers and retailers to determine their inventory on hand and calculate the excise tax liability owed based on the new tax rate (see page 24, "Floor Tax" section).

The distributor who manufactures or imports tobacco products (other than cigarettes) into the State is initially responsible for paying the excise tax, equal to 37 percent of their wholesale price. Excise stamps are not required on tobacco products other than cigarettes, but wholesalers and retailers are required to have a receipt on hand from the distributor showing that the excise tax has been paid. If they are unable to produce a proof of tax payment receipt, then the retailer would become liable for the tax.

All cigarettes and tobacco products are subject to regular State and county **sales taxes** at the point of sale to the consumer.⁶ The location of the final sale determines the appropriate sales tax rate, and sales tax collections are allocated between the State and county where the sale occurred.

⁶Article 28, Section 1103 of the Tax Law, "Prepayment of sales tax on cigarettes," deals with cigarettes only. Section 1105 applies sales tax to "tangible personal property," unless specifically excluded, and cigarettes and other tobacco products are not excluded.

The State sales tax is currently 4.25 percent, which includes a 0.25 percent temporary sales tax surcharge. The City of New York imposes an additional sales tax of 4.125 percent, including a 0.125 percent temporary surcharge. Both the State and City surcharges are scheduled to lapse on May 31, 2005. Finally, there is a 0.25 percent sales tax surcharge in the Metropolitan Commuter Transportation District, which includes New York City, levied to support the Metropolitan Transportation Authority. Therefore, the total sales tax currently imposed in New York City is 8.625 percent.

Health Effects of Smoking

The regulation of cigarette and tobacco sales serves a public health purpose, as well as a tax administration purpose. Tobacco use is the leading cause of preventable death and disease in the United States. Most tobacco users begin using tobacco in early adolescence, and almost all first-use occurs before age 18.⁷ In 1999 (the most recent data available), tobacco use caused more than 24,500 deaths in New York State. Each person whose death in 1999 was attributed to smoking lost, on average, 13.7 years of life.⁸ Smoking kills more people than alcohol, AIDS, car crashes, illegal drugs, murders and suicides combined, and thousands more die from other tobacco-related causes, such as fires caused by smoking and smokeless tobacco use.⁹

In 2002, the prevalence of adult smokers in the State was 22.3 percent, or approximately 3.1 million adults.¹⁰ The prevalence of smoking among high school students in New York State in 2000 was 26.8 percent.¹¹ Medical costs in the State associated with smoking were more than \$6.4 billion in 1999.¹² However, these costs could be on the decrease since the New York City Department of Health and Mental Hygiene recently reported an 11 percent decline in the number of smokers from 2002 to 2003, which represents 100,000 fewer New Yorkers smoking from year to year. The City estimates that at least 30,000 premature deaths will be avoided as a result. Smoking rates declined among all age groups, especially young people. Rates also declined in all boroughs, among both men and women, and among all racial and ethnic groups. Furthermore, the decline in smoking means that 150,000 people will no longer be exposed to second-hand smoke at the workplace and 100,000 fewer family members will have to endure second-hand smoke.¹³ The City's Health Commissioner, Dr. Thomas R. Frieden, attributes the drop to higher cigarette taxes, legislation to reduce exposure to second-hand smoke, a nicotine patch distribution program and public education about the health risks of tobacco use.

Over the last several years, a broad coalition of groups has been working to implement a comprehensive tobacco control policy in the State that includes public education, higher excise taxes, regulations to reduce the influence of tobacco industry

⁷ New York State Department of Health, *Cigarette Smoking Among Adults – New York State 2002*, April 2003.

⁸ Centers for Disease Control and Prevention, *Smoking-Attributable Mortality, Morbidity, and Economic Costs (SAMMEC): Adult SAMMEC and Maternal and Child Care SAMMEC Software*, June 3, 2004. <<http://www.cdc.gov/toabacco/sammec>>.

⁹ National Center for Tobacco-Free Kids, *The Toll of Tobacco In New York*, June 3, 2004.

<<http://www.tobaccofreekids.org/reports/settlements/TobaccoTollPrint.php3?StateID=NY>>.

¹⁰ New York State Department of Health, *Tobacco Use Among Adults New York State, 2002*, revised May 2004. <<http://www.health.state.ny.us/nysdoh/tobacco/reports/brfss2002.htm>>.

¹¹ Centers for Disease Control and Prevention, *Tobacco Information and Prevention Source: New York Highlights*, June 3, 2004 <http://www.cdc.gov/tobacco/statehi/html_2002/new_york.htm>.

¹² New York State Department of Health, *Cigarette Smoking Among Adults – New York State 2002*, April 2003.

¹³ New York City Department of Health and Mental Hygiene Press Release, "New York City's Smoking Rate Declines Rapidly From 2002 to 2003, the Most Significant One-Year Drop Ever Recorded," May 12, 2004. <<http://www.nyc.gov/html/doh/html/public/press04/pr052-0512.html>>.

marketing and regulations eliminating tobacco smoke in public places. The coalition includes groups, such as the American Cancer Society, the American Heart Association, the American Lung Association and the New York Public Interest Research Group.

In 2002, the excise tax in New York State increased by 35 percent, while the excise tax in New York City increased by 1,775 percent, or nearly 18 times the previous tax rate. Increases in cigarette taxes have been found to reduce smoking levels, especially among teenagers.¹⁴ When cigarettes cost more, adults smoke less and fewer teens start smoking. Fewer smokers mean fewer cancer cases and deaths.¹⁵ The State has also benefited from these increased taxes by using the associated revenues for expanding health care coverage for the uninsured and for public health programs designed to reduce smoking. In March 2003, the coalition was successful in working with the State Legislature to enact a statewide smokefree workplace law, banning smoking in all indoor workplaces, including restaurants and bars.

Enactment of the Smokefree Workplace Law earned New York an "A" in the American Lung Association's annual State of Tobacco Control Report for 2003.¹⁶ According to Dr. Richard Sargent, author of a study on a smoking ban in all public buildings in Helena, Montana, eight hours of working in a smoky bar is equivalent to smoking a pack of cigarettes a day. In such an environment, other studies have shown workers more than double their chances of developing cancer and asthma, and pregnant workers put themselves at risk for miscarriage and premature delivery.¹⁷ But with business owners working to amend this law, the American Lung Association of New York State has launched a grass roots effort to protect the law from being eroded and weakened.

The coalition also continues to press the State to beef-up its public education and enforcement efforts. In 1999, New York established an anti-smoking, public health education campaign with an annual budget of more than \$40 million and administered by the Department of Health. The program began in 2000 and was required to use the most effective research in designing its public education and mass media advertising. But coalition members have found the program ineffective, failing to emphasize changing social norms and, instead, focusing on changing individual behaviors.¹⁸ The program has also been identified by the coalition as needing to be more aggressive, hard hitting and better financed. Under guidelines of the Centers for Disease Control and Prevention, the State should be spending at least \$95 million annually to run an effective program.

¹⁴ RTI International, Prepared for Tobacco Technical Assistance Consortium, Emory University, Rollins School of Public Health, *State Cigarette Excise Taxes: Implications for Revenue and Tax Evasion*, May 2003.

¹⁵ Batista, Henry. Executive Vice President of the American Cancer Society. Letter to the Editor, *Newsday*. December 17, 2001.

¹⁶ <<http://lungaction.org/reports/tobacco-control03.html>>. June 3, 2004.

¹⁷ Ellis, Rosemary. Editorial Director of Prevention Magazine. "The Secondhand Smoking Gun." *The New York Times*. October 15, 2003.

¹⁸ Horner, Blair Horner and Michelle Stern. New York Public Interest Research Group. "Blowing Away the Smokescreen: A Case Against Big Tobacco." March 2003.

In 2001, the Office of the State Comptroller reviewed this program and found that the Department of Health had only expended about \$24.6 million of the more than \$40 million allocated for the program at that time.¹⁹ The audit reported that the Department did not have a sufficient performance measurement system to assess the effectiveness of the program in achieving its goals and was late in having an independent evaluation of the program performed. Seven out of twenty-five organizations had been working on program activities without a contract for more than a year and a half. By allowing these organizations to work without a contract, the Department placed the program at unnecessary risk that activities would not be effectively performed.

The work of the coalition to raise cigarette taxes, prevent smoking in all indoor workplaces and raise public awareness of the dangers of smoking has resulted in immeasurable benefits to the health of New Yorkers. However, cigarette enforcement efforts must be as effective as possible and monitored on an ongoing basis to continue the fight to prevent the youth of the State from ever starting to smoke and to prevent illegal cigarette sales activity.

¹⁹ Office of the State Comptroller, *Department of Health Tobacco Use Prevention and Control Program*, Report 2001-S-19, April 2002.

Audit Overview

In October 2003, the Office of the State Comptroller released an audit of Tax and Finance, entitled *Selected Controls over Cigarette Licensing and Excise Taxes* (Report 2002-S-58). A similar audit of Consumer Affairs and City Finance was released in July 2004 entitled *Selected Controls over Licensing of Cigarette Retailers and Wholesalers* (Report 2003-N-7). Although these two audits were conducted independently, both reviewed similar questions.

The audits found that while Tax and Finance, Consumer Affairs and City Finance expend significant resources to enforce State and City Tax Laws related to cigarettes and other tobacco products, a lack of communication among agencies when agent, wholesaler and retailer licenses have been suspended, revoked, surrendered or not renewed has made it difficult to target those vendors for closer review. In addition, a general lack and use of written procedures has hampered the efforts of enforcement personnel, making it more difficult than necessary to manage these operations. Given the potential increase in State and City revenues that could occur through improvements in agency operations and coordination, the recommendations contained in the audits and this report should be considered and implemented to the greatest extent feasible.

Tax and Finance - Selected Controls over Cigarette Licensing and Excise Taxes

The objective of this audit was to determine if Tax and Finance had adequate controls over cigarette licensing and excise tax revenue for the period January 1, 2000 through March 31, 2003. The audit found that Tax and Finance needs to improve procedures to detect unregistered retailers, follow up on overdue excise taxes related to the 2002 floor tax increase and better control the cigarette tax stamp process.

Identifying Unlicensed Retailers

The annual Tax and Finance license process for retailers selling cigarettes and other tobacco products to consumers is one step used to ensure legal sales and the payment of State sales and excise taxes. According to Tax and Finance, as of 2003, there were approximately 25,000 registered retailers in the State. Of these, nearly 3,800 retailers that were licensed for calendar year 2001 and/or 2002 did not renew their license for 2003. In a sample survey of 81 retailers, auditors found that 21 retailers (26 percent) were illegally selling cigarettes.²⁰ Four of these illegal retailers were selling cigarettes in New York City with State-only stamps, resulting in a loss of

²⁰ Geographically-based judgment survey included 20 retailers in the Capital Region, 20 retailers in the Central New York Region and 41 retailers in the New York City area.

City excise tax revenue, and one retailer was selling cigarettes without any tax stamp at all.

While not a random sample, the results indicate that aggressively investigating retailers with lapsed licenses would identify a significant number of Tax Law violations, which could result in improved revenues for both the State and City. The report noted that Tax and Finance would benefit from written procedures requiring the notification to enforcement personnel when retailer licenses are not renewed. Tax and Finance should also develop procedures to provide this notification to wholesalers, since Tax Law requires that wholesalers sell cigarettes and tobacco products only to licensed retailers.

Tax and Finance has recently developed a website to assist wholesalers by listing retailers with valid State licenses. Creation of this website should serve to hold wholesalers responsible for sales to illegal retailers and in return should reduce illegal sales.

Collection of the 2002 Floor Tax

Effective April 3, 2002, the State's excise tax on cigarettes increased from \$1.11 to \$1.50, significantly increasing the tax liability for cigarettes with excise tax stamps already purchased at the lower tax rate. To accurately apply the new tax levy, each agent, wholesaler and retailer needed to determine his or her inventory on hand at the close of business April 2, 2002, calculate the new excise tax liability (referred to as a "floor tax") and file a return with Tax and Finance recognizing that liability. Tax and Finance reported collecting \$29.5 million in floor taxes.²¹

Tax and Finance monitored this process by conducting a physical inventory of cigarettes on hand at 98 locations (accounting for 93 agents) and at 13,363 locations for wholesalers and retailers. The Comptroller's audit found that nearly one year later, Tax and Finance had not complied with its procedures to follow up and determine whether the agents, wholesalers and retailers submitted the correct amount of excise tax owed. This lack of effective monitoring increases the risk that Tax and Finance has not collected the total new tax liability owed.

In assessing Tax and Finance's performance in ensuring vendor payment of the floor tax, auditors reviewed the records of a judgment sample of 316 cigarette vendors to determine if the vendors had remitted the appropriate tax amount to the State.²² These vendors had been inventoried by Tax and Finance and found to have a potential tax liability. Of the vendors sampled, the auditors found that 153 (48 percent) had underpaid the State nearly \$613,000 because the vendor had either: 1) not yet filed a

²¹ Office of the State Comptroller, *Selected Controls Over Cigarette Licensing and Excise Taxes*, Appendix B, Report 2002-S-58, October 2003.

²² The judgment sample consisted of 93 agents, 49 wholesalers and 174 retailers. The sample excluded retailers and wholesalers who are part of a large chain because a combined return may have been filed under another retailer, wholesaler or agent.

return, 2) filed a return indicating no additional tax was due, or 3) filed an erroneous return and payment. Tax and Finance had not followed up with the vendors to resolve the unpaid taxes in a timely manner. Tax and Finance officials attributed this lack of follow up to programming issues—reduced staffing and the volume of non-filers—and indicated that the project should have reached completion in September 2003.

Internal Controls Over Tax Stamps

Tax stamps are manufactured under contract by Meyercord, Inc. in Illinois and shipped to and stored at various sites in the State maintained by another State contractor. The audit reported there were certain internal control procedures lacking. As part of an effective system of internal control, Tax and Finance should maintain formal written procedures for safeguarding the production, distribution and storage of its stamp inventories. In addition, Tax and Finance should conduct periodic site visits to ensure that the stamp inventory is accounted for and properly managed.

Recommendations

The audit report made eight recommendations addressing the issue of unregistered cigarette retailers, collection of the April 3, 2002 floor tax and internal controls over Tax Stamps. These recommendations are detailed in Appendix A. Tax and Finance agreed with nearly all of the recommendations and indicated that some have already been implemented.²³

Consumer Affairs and City Finance - Selected Controls over Licensing of Cigarette Retailers and Wholesalers

In addition to a valid State license, New York City requires cigarette retailers and wholesalers to have a separate City-issued license. Licenses for retailers are obtained from Consumer Affairs, while wholesaler licenses are acquired through City Finance. Unlike the State, however, the City does not require a license for the sale of tobacco products other than cigarettes.

As with the State, New York City also imposes a separate \$1.50 cigarette excise tax per pack. The City excise tax is paid in addition to the \$1.50 State excise tax and, when combined, makes cigarettes sold in New York City among the most expensive in the country. The City's high tax rate, coupled with the availability of untaxed or under-taxed cigarettes, makes the sale of unstamped cigarettes increasingly attractive for City retailers.

²³ Office of the State Comptroller, *Department of Taxation and Finance, Selected Controls Over Cigarette Licensing and Excise Taxes*, Appendix B, Report 2002-S-58, October 2003.

The objectives of this audit were to determine whether Consumer Affairs and City Finance maintain accurate licensing data for cigarette retailers and wholesalers and to determine whether City agencies ensure that retailers and wholesalers with expired, suspended, revoked or surrendered licenses are not selling cigarettes. The audit period was January 1, 2001 through October 31, 2003. The audit found that Consumer Affairs and City Finance do perform follow-up reviews on retailers and wholesalers that have expired, suspended or revoked New York City licenses to ensure these vendors are no longer selling cigarettes. However, the City agencies could benefit from more accurate licensing data and improved enforcement activities through improved communication and coordination with Tax and Finance. This could be achieved by formalizing licensing and enforcement-related activities through written procedures. The City agencies agreed with the audit recommendations and indicated that they were working toward implementation.

Licensing of Cigarette Retailers

All cigarette retailers in the City of New York must have a valid City retail cigarette license, as well as a valid State license. In addition to issuing retail licenses, Consumer Affairs combines its licensing enforcement efforts with the enforcement operations used in restrictions on the sale of cigarettes to minors.

The City and State utilize separate information systems to track licenses. Examination and comparison of these City and State systems identified significant differences in the way retailer data is collected and stored. While the retailers must submit similar information to the State and City, some of that data is not entered into either system, making comparative monitoring of licensure difficult. For example, both the City and State systems request a sales tax identification (ID) number, yet less than 6 percent of the approved retailers in the City database had a valid sales tax ID number. Having key identifying information on both the State and City systems would improve monitoring and enforcement.

Auditors comparing Tax and Finance and Consumer Affairs retailer records identified 3,583 retailers with valid State licenses, but no current City license. Based on a random sample of visits to 85 of the retailers, the auditors projected with a 90 percent confidence level that between 285 (8 percent) and 725 (20 percent) of these 3,583 retailers were selling cigarettes without a current City license. The auditors attributed the variation in part to the failure of the State and City to compare records to ensure that retailers have the required State license before applying for a City license and that the information for all retailers is correctly entered in each database.

According to the audit, communication issues also limited Consumer Affairs' retailer licensing operations. Consumer Affairs fails to notify Tax and Finance when it suspends or revokes a New York City license. This weakness accounted for retailers found by the auditors with revoked or suspended City licenses, but current State licenses. Additionally, Consumer Affairs does not notify wholesalers when a retailer has

had his or her license suspended or revoked, thereby missing an opportunity to prevent wholesalers from illegally selling cigarettes to the retailer.

Licensing of Cigarette Wholesalers

Similar to the requirements for cigarette retailers, wholesalers in New York City must first have a valid State license and then subsequently obtain a City wholesale license from City Finance. If a wholesaler's State license is suspended or revoked, that wholesaler's City license is to be revoked as well.

Review of State and City records found both wholesalers with a valid City license and no State license, and wholesalers with a valid State license, but expired City license. While City Finance did follow up on the identified wholesaler licensure violations, the audit determined that City Finance has no formal written procedures for the wholesale license review and approval process, nor does it have a formal written, long-term strategic plan for the enforcement of the cigarette licensing laws. Like the file matching activities employed during the audit, such a plan would help to ensure effective coordination and communication activities between State and City Finance.

Recommendations

The audit made nine recommendations, six of which were addressed to Consumer Affairs and the remaining three recommendations to City Finance. The recommendations detailed in Appendix B were aimed at improving and formalizing cigarette licensing and enforcement activities. Consumer Affairs and City Finance agreed with all of the recommendations and have already begun working to implement them. Additionally, Consumer Affairs indicated it is seeking opportunities to improve its licensing and enforcement systems and processes.

Tobacco Revenue Collection and Enforcement

Revenue Collections

In State fiscal year (SFY) 2003-04, the revenues derived from licensing, sales and excise taxes are estimated to have totaled \$1.1 billion to the State and \$171 million to the City in City fiscal year (CFY) 2002-03. Between 1994 and 2003, the State collected over \$7.7 billion in cigarette excise taxes and an additional \$223 million in other tobacco revenues.²⁴ In SFY 2003, cigarette excise tax collections represented 2.8 percent of all New York State tax collections. In the same year, the State of California collected \$1.05 billion in cigarette excise taxes, but this accounted for only 1.3 percent of its total tax collections. Some neighboring states, however, are even more dependent on cigarettes than New York. Pennsylvania collected \$877 million, or 3.8 percent of its revenues from cigarettes in 2003, while New Jersey's collections of \$643 million represented 3.2 percent of its revenues.²⁵ New York State, New York City and the 57 other counties outside of New York City all receive a portion of the sales tax revenues, but only the State and New York City receive license and excise tax revenues.

2003 Selected State Cigarette Tax Collections
(in millions)

Rank	State	Cigarette Taxes	% All Taxes
1	New York	\$1,116.7	2.75%
2	California	\$1,055.5	1.33%
3	Michigan	\$892.1	3.92%
4	Pennsylvania	\$877.1	3.78%
5	New Jersey	\$642.8	3.22%
6	Illinois	\$605.1	2.73%
7	Ohio	\$599.9	2.91%
8	Texas	\$582.7	2.00%
9	Florida	\$478.6	1.78%
10	Massachusetts	\$451.0	2.89%
11	Washington	\$362.4	2.80%
12	Indiana	\$352.4	3.14%
13	Wisconsin	\$309.2	2.54%
14	Maryland	\$279.0	2.54%
15	Connecticut	\$253.8	2.67%
24	Rhode Island	\$94.9	4.21%
25	Iowa	\$94.9	1.88%
26	Maine	\$94.4	3.50%
27	New Hampshire	\$94.0	4.80%
28	Vermont	\$87.6	5.62%

Source: Census Bureau, 2003 State Government Tax Collections
<<http://ftp2.census.gov/govs/statetax/03staxss.xls>>

²⁴ New York State Department of Taxation and Finance, *2002-2003 New York State Tax Collections*, Table 13, January 2004.

²⁵ Census Bureau, *2003 State Government Tax Collections*.

The State cigarette excise tax per pack has increased dramatically over the past decade, going from \$0.39 to \$0.56 in 1993, then to \$1.11 in 2000 and finally to \$1.50 in 2002. This rate is comparable with neighboring states, as shown in the following table. It is important to note that neighboring states tend not to have local taxes, so a combination of New York State and New York City taxes makes cigarettes in New York City the highest taxed in the nation.

Other State Cigarette Excise Tax Rates²⁶
(as of January 2004)

National Rank²⁷	State	Rate²⁸
1	New Jersey	\$2.05
2	Rhode Island	\$1.71
3 (tied)	Massachusetts Connecticut	\$1.51
5	New York	\$1.50
6	Pennsylvania	\$1.35
10	Vermont	\$1.19
12	Maine	\$1.00
34	New Hampshire	\$0.52
47	South Carolina	\$0.07
48	North Carolina	\$0.05
49	Kentucky	\$0.03
50	Virginia	\$0.025

In 2002, the City excise tax rate also increased substantially, jumping from \$0.08 to \$1.50 per pack. In addition to the State and City excise taxes, the federal government also imposes an excise tax on cigarettes, now \$0.39 per pack.

The State collected over \$1 billion in cigarette and tobacco excise taxes in SFY 2003-04.²⁹ Revenues generated by the State cigarette excise tax are split between the State's General Fund (38.8 percent) and the Tobacco Control and Insurance Initiatives Pool (61.2 percent) created by the Health Care Reform Act of 2000 (HCRA) to reduce the number of uninsured New Yorkers and support anti-smoking efforts.³⁰ Studies show that in addition to raising revenue for vital health care programs, higher cigarette

²⁶ Federation of Tax Administrators, *State Excise Tax Rates on Cigarettes*, January 1, 2004.

<<http://www.taxadmin.org/fta/rate/cigarette.html>>.

²⁷ State rank based on total state excise tax.

²⁸ Rates are stated in cents per pack of 20 cigarettes and exclude federal, local and other associated taxes.

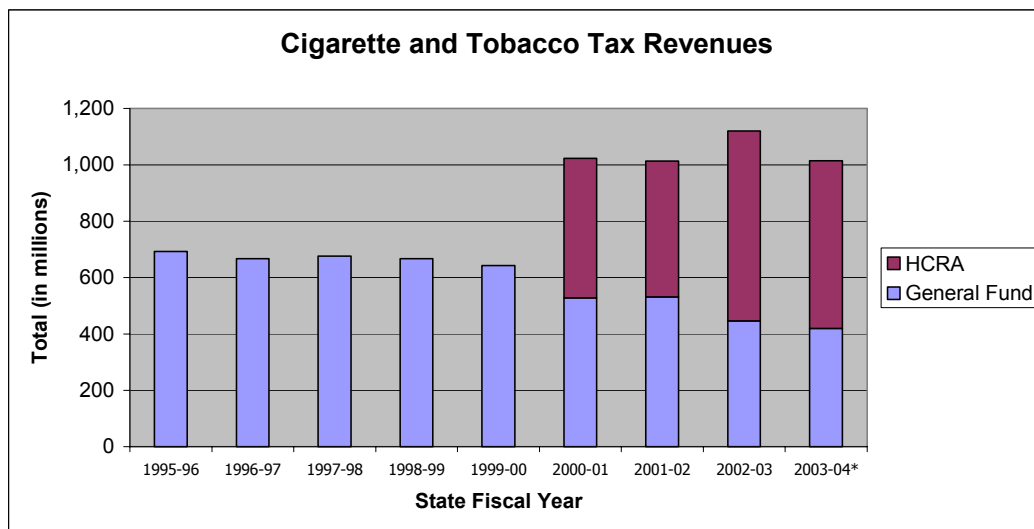
²⁹ Office of the State Comptroller, *Comptroller's Monthly Report on State Funds Cash Basis of Accounting*, March 2004. <<http://www.osc.state.ny.us/finance/finreports/cash/monthly/march04.pdf>>.

³⁰ Article 20, Section 482 of the Tax Law. The Tobacco Control and Initiatives Insurance Pool was established in the Health Care Reform Act of 2000.

taxes are one of the most effective ways to reduce smoking among both youth and adults.^{31 32 33}

In SFY 2003-04, about \$419 million of these monies were deposited into the State's General Fund, and \$594 million was transferred to the Tobacco Control and Insurance Initiatives Pool. Additionally, starting in 2002, 46 percent of the New York City cigarette excise tax has been dedicated to the pool, as well. For SFY 2003-04, \$104 million from the City's cigarette excise tax was transferred to this pool. Since 2000, over \$2.45 billion in State and City cigarette revenues have been dedicated to HCRA for health care related purposes.^{34 35}

A portion of the HCRA tobacco pool revenue is spent "off-budget," that is, not included in the Executive Budget or accounted for in the State's financial reports. This is the only instance where State tax receipts are transferred and spent in such a way. In April 2003, the Office of the State Comptroller released a report which called for moving all HCRA revenues and spending to the State budget in order to provide more checks and balances on HCRA collections and disbursements.³⁶ Currently, under HCRA, the State Comptroller cannot provide a comprehensive accounting of the flow of funds since most collections and many disbursements are independent of the State accounting and budget processes.



Source: 2004-05 Executive Budget Financial Plan, pages 248-249
 * Estimated

³¹ New York City Department of Health and Mental Hygiene Press Release, "New York City's Smoking Rate Declines Rapidly from 2002 to 2003, the Most Significant One-Year Drop Ever Recorded," May 12, 2004.
³² Tauras, John A., Patrick M. O'Malley and Lloyd D. Johnston. "Effects of Price and Access Laws on Teen Smoking Initiation: A National Longitudinal Analysis. April 2001.
³³ Czart, C., R.I. Pacula, F.J. Chaloupka and H. Wechsler. "The Impact of Prices and Control Policies on Cigarette Smoking Among College Students." March 2001.
³⁴ Division of the Budget, *New York State 2004-05 Executive Budget*, Appendix II, p. 248.
³⁵ HCRA, Office of Pool Administration.
³⁶ Office of the State Comptroller, *The Health Care Reform Act (HCRA): The Need to Restore Accountability to State Taxpayers*, April 2003.

Since sales tax collections on cigarettes and tobacco products are not segregated from general sales tax receipts, it is not possible to exactly determine the total sales tax revenues generated by cigarette and tobacco sales. However, the minimum State sales tax collections for cigarettes alone can be estimated by applying an average 4 percent State sales tax rate to the minimum sales price of cigarettes, and then multiplying that number by the number of excise tax stamps sold.³⁷

The following table illustrates the most recent figures available for total revenue collections. The State and City figures are not strictly comparable because of the differences in their fiscal years.³⁸ The total for the State excise tax collection is based on Executive Budget estimates and includes amounts to be transferred to the off-budget HCRA pool. The table shows that State excise tax collections in SFY 2003-04 are down by nearly \$107 million from the prior year. New York City excise tax revenues are shown to have increased dramatically—nearly 480 percent, reflecting a large City excise tax rate increase in 2002, from \$0.08 to \$1.50 per pack.

Summary of State and City Revenues
(in millions)

Fiscal Year	New York State				New York City			
	2002-03	2003-04	Change	% Change	2001-02	2002-03	Change	% Change
Excise*	\$1,116.7	\$1,009.8	(\$106.9)	-9.6%	\$27.4	\$158.4	\$131.0	477.4%
Sales**	\$150.6	\$136.3	(\$14.3)	-9.5%	\$23.5	\$12.5	(\$11.0)	-46.8%
Total	\$1,267.2	\$1,146.1	(\$121.1)	-9.6%	\$51.0	\$171.0	\$120.0	235.3%

Source: New York State Department of Taxation and Finance; New York State Division of the Budget; New York City Comptroller

* 2003-04 New York State excise tax estimate by Division of the Budget

** Sales tax figures are estimates based on number of stamps issued.

Net State cigarette excise tax collections increased by \$90 million in SFY 2002-03 from SFY 2001-02, reflecting a partial year impact of the higher tax rates imposed in 2002. Total State collections had increased by \$365.4 million, or 55.6 percent, since 1994. State sales tax revenues are estimated to have declined. The minimum collected in SFY 2003-04—\$136.3 million—is down \$14 million from the previous year.

³⁷ The State sales tax increased by 0.25 percent to 4.25 percent on June 1, 2003. Since the audit of the State Department of Taxation and Finance covered the period from January 1, 2000 to March 31, 2003 and the audit of the City Departments of Consumer Affairs and Finance covered the period from January 1, 2001 to October 31, 2003, the use of a 4 percent sales tax rate may somewhat underestimate total actual sales tax collections in New York City.

³⁸ The State fiscal year runs from April 1 to March 31, while the City fiscal year runs from July 1 to June 30.

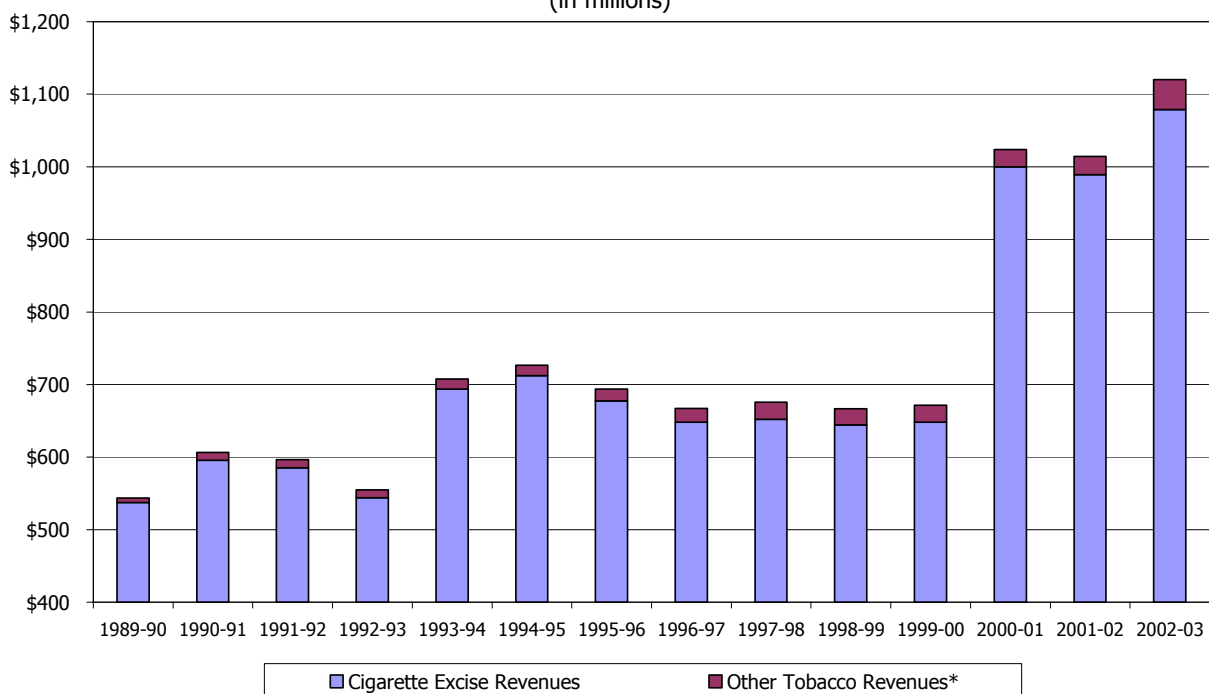
New York State Cigarette and Tobacco Tax Collections
SFY 1994 - 2003
(in millions)

Fiscal Year	Total Sales	Minus Commissions	Credit, Sales Prior Periods	Net Cigarette Excise Tax	Tobacco Excise	Total Excise	Cigarette Licenses	Cigarette Stickers	Total Other*
1993-94	\$693.2	(\$2.5)	\$3.0	\$693.6	\$11.2	\$704.9	\$2.6	\$0.2	\$14.0
1994-95	\$713.5	(\$2.4)	\$1.1	\$712.2	\$11.6	\$723.8	\$2.5	\$0.2	\$14.4
1995-96	\$679.4	(\$2.3)	\$0.2	\$677.3	\$13.2	\$690.6	\$2.7	\$0.2	\$16.1
1996-97	\$649.8	(\$2.2)	\$0.4	\$648.0	\$16.2	\$664.2	\$2.7	\$0.2	\$19.1
1997-98	\$657.2	(\$2.2)	(\$2.8)	\$652.2	\$19.9	\$672.1	\$3.1	\$0.1	\$23.1
1998-99	\$648.3	(\$2.1)	(\$1.8)	\$644.4	\$18.8	\$663.3	\$3.3	\$0.1	\$22.3
1999-00	\$649.3	(\$2.1)	\$1.0	\$648.1	\$20.1	\$668.3	\$3.3	\$0.1	\$23.5
2000-01	\$988.7	(\$3.2)	\$14.3	\$999.8	\$20.5	\$1,020.3	\$3.3	\$0.1	\$24.0
2001-02	\$991.9	(\$3.1)	\$0.2	\$989.0	\$21.9	\$1,010.9	\$3.2	\$0.1	\$25.3
2002-03	\$1,047.7	(\$3.2)	\$34.6	\$1,079.0	\$37.6	\$1,116.7	\$3.1	\$0.1	\$40.9

Source: New York State Department of Taxation and Finance, *2003-2003 New York State Tax Collections*, Table 13, January 2004.

* Other tobacco revenue includes tobacco product excise taxes, cigarette licenses and cigarette stickers.

New York State
Cigarette and Tobacco Product Revenues
SFY 1990 - 2003
(in millions)

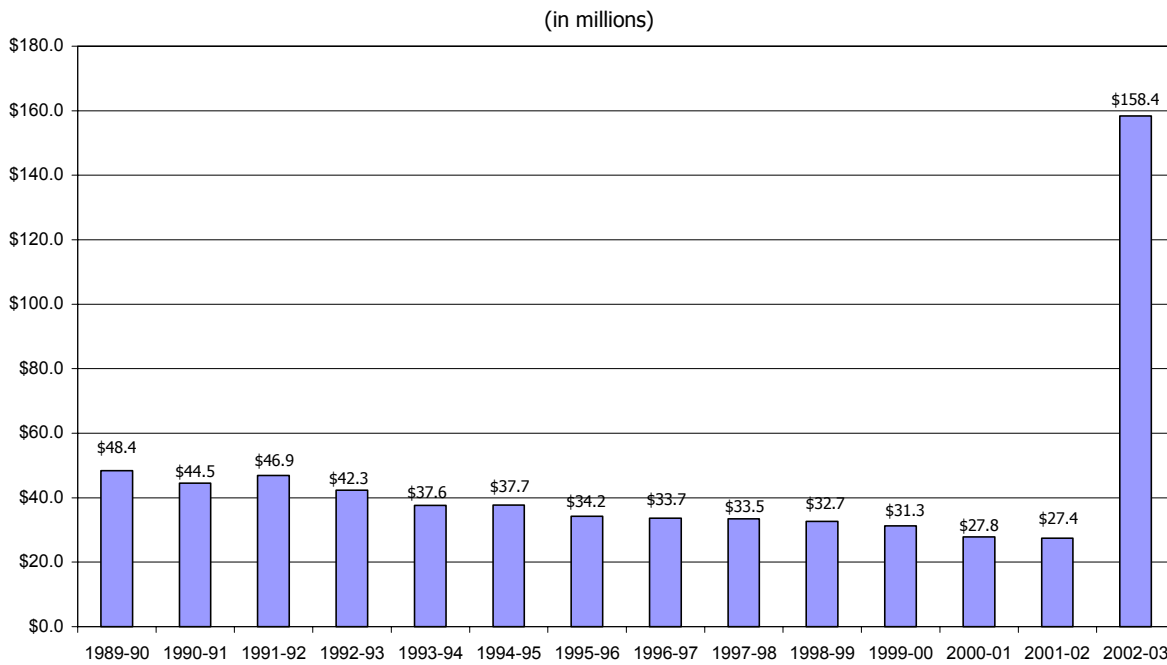


Source: New York State Department of Taxation and Finance

* Other tobacco revenue includes tobacco product excise taxes, cigarette licenses and cigarette stickers.

As shown below, New York City cigarette excise collections had been on a declining slope for the past decade, but the tax increase imposed in 2002 caused a \$131.0 million, or 477.4 percent jump in collections for CFY 2002-03. In addition, City sales tax collections likewise declined, dropping from an estimated \$23.5 million in CFY 2001-02 to \$12.5 million in CFY 2002-03.

New York City Cigarette Excise Tax Revenue CFY 1990 - 2003



Source: NYC Department of Finance

Fees from license renewals bring in additional revenues to the State and City, with retailers accounting for the bulk of this revenue. The \$100 annual fee associated with a State retailer license likely generates about \$2.5 million, while the annual City retail license fee of \$110 generates about \$1.4 million. Agent and wholesaler license fees for both the State and City raise negligible amounts of revenue because they are only sporadically assessed, and there are significantly fewer businesses with these licenses.

Enforcement

Tax evasion—especially bootlegging and Internet sales—led the State to adopt stronger tax enforcement measures in recent years. Chapter 262 of the Laws of 2000 created new restrictions against the importation and distribution of untaxed cigarettes. The civil and criminal penalties for tax evasion were also increased.

Violation of the various provisions of the State and City Tax Law can result in penalties ranging from fines to criminal misdemeanors and, in some cases, Class E felonies. The State Tax and Finance Enforcement Division is responsible for identifying and taking action against agents, wholesalers and retailers who are in noncompliance with the Tax Law. The City Finance Enforcement Division performs this function in New York City.

Both agencies are responsible for performing inspections and audits of licensed agents, wholesalers and retailers to ensure licenses are current, excise taxes have been paid on all cigarettes and tobacco products in their possession, and vendors have maintained proper sales documentation. If vendors have resold cigarettes or other tobacco products to other wholesalers or retailers, they can be required by enforcement personnel to produce documentation on such sales, including the name and address of the purchaser.

Licensed agents, wholesalers and retailers are required to verify that all cigarettes and other tobacco products in their possession have been subjected to all applicable excise taxes. This verification is accomplished by examining the excise tax stamps that are required to be affixed to cigarette packages and by maintaining copies of invoices from tobacco product distributors showing that the excise tax has been paid based on the wholesale value of the products. If a wholesaler or retailer determines that he or she is in possession of cigarettes or tobacco products for which the appropriate excise taxes have not been paid, the individual is to report that discrepancy to the source of those cigarettes, who then becomes responsible for replacing them with properly licensed cigarettes.

Agents and distributors are prohibited from selling cigarettes and other tobacco products to an unlicensed wholesaler or to a wholesaler whose license has been suspended or revoked.³⁹ In order to meet the licensing requirements, wholesalers must ensure that they are not aiding or abetting others in violating the Tax Law. Retailers are also responsible for enforcing those sections of Public Health Law dealing with the sale of cigarettes and other tobacco products to minors. Violations can result in the suspension or revocation of a retailer's license to distribute or sell cigarettes and other tobacco products.

One factor that makes the supervision of retail sales difficult is the high rate at which small retailers are both established and go out of business. What's more, the rate of turnover has increased over the past decade, leading to a large increase in the number of new retailers requesting licenses and former retailers surrendering their licenses. This turnover rate makes it difficult to determine if a new retailer has a valid license and if an existing retailer has surrendered his or her retailer license.

There is heightened concern that the problem of cigarette tax evasion is growing and that untaxed cigarettes are entering the New York market in increasing amounts.

³⁹ Section 480, paragraph (k) of the New York State Tax Law.

Two sources of untaxed cigarettes are out-of-state sales and Internet purchases. While most of the states sharing New York's borders impose similar tax rates, hundreds of direct order and Internet retailers now offer direct shipment of untaxed cigarettes to New York consumers at prices substantially below their regulated cost.⁴⁰ Many of these retailers advertise that consumers must be 18 years or older in order to purchase cigarettes and that all applicable sales and excise taxes are the responsibility of the consumer. However, there is no process to confirm the purchaser's legal age, nor is there a mechanism in place to properly assess New York State or New York City taxes. Additionally, taxes are not levied on cigarettes sold on Indian reservations in the State.

Tax evasion is not the only cause of decreasing revenues. All other things being equal, cigarette excise tax revenues can be anticipated to decline over the long run due to consumer resistance to the rising retail cost of cigarettes (non-tax cost increases) and the on-going reduction of the number of smokers. In addition, changes in public policy have created active barriers to smoking. These include banning smoking in public places throughout New York State and making free nicotine patches available to smokers in New York City to help them quit. The recent increases in State and City excise tax increases have also encouraged many people to quit. All of these factors reduce cigarette consumption, and this resulted in a general declining revenue trend during most of the 1990s, as shown in the revenue graphs and tables above.

New York has offset the revenue impact of decreased legal consumption by increasing State and City excise taxes. State revenues increased significantly following the State excise tax increases of 2000 and 2002, as shown in the graph of State revenues. City revenues, likewise, jumped following the large increase in City excise taxes in 2002, shown in the graph of City revenues. However, once new excise taxes have realized their initial impact, the long-term trend toward revenue declines can be expected to resume.⁴¹ Improved cooperation between State and City enforcement agencies, as well as the creation of common data elements and shared communication, will help offset this trend.

⁴⁰ For example, the website <<http://www.smokesignals.com/index.asp>> offers cartons of cigarettes at prices starting at \$9.99. The legal minimum retail sales price per carton for standard brands in New York State is \$47.61 (New York State Tax Department of Taxation and Finance, Publication 509).

⁴¹ *New York State 2004-05 Executive Budget, Revenue Estimating Methodology*, pg. 58-59. RTI International, *State Cigarette Excise Taxes: Implications for Revenue and Tax Evasion*, pg. 1. May 2003.

Opportunities for Improved Licensing and Enforcement Activities

The State Department of Taxation and Finance (Tax and Finance), New York City Department of Consumer Affairs (Consumer Affairs) and New York City Department of Finance (City Finance) expend significant resources for efficient and effective collection of cigarette and other tobacco product revenues. However, opportunities for tax evasion through the sale of unstamped or improperly stamped cigarettes, combined with the large territory to be covered with limited enforcement resources, make the coordination of effort between the State and City agencies essential.

The recommendations contained in the audits were developed based on essentially independent observations of each agency's operations. Examined together, the audits highlight additional opportunities for improvement through better coordination and communication among the City and State agencies. The implementation of improved efficiencies in administration and enforcement of cigarette and tobacco licensure should result in quicker detection of illegal sales, more effective enforcement actions and enhanced revenue collections.

Coordinated State/City Licensing Process

Of the 25,000 cigarette retailers and 300 wholesalers statewide, 13,363 retailers and 160 wholesalers are located in New York City. City-based vendors are required to be licensed by both the State and the City. The audits determined, however, that during the application process, there is no mechanism to ensure that cigarette retailers and wholesalers are lawfully licensed by both the State and City. As a result, the audits found retailers and wholesalers illegally selling cigarettes.

Currently, each agency independently licenses vendors through an application process without much involvement or coordination with other agencies. Since the license application forms provide the data maintained on the license information systems, the collected data is essentially the core from which most cigarette licensing and enforcement activities are based. Therefore, the information systems must contain sufficient and accurate data that is comprehensive to each agency to aid licensing and enforcement activities among the State and City agencies.

The audit of Consumer Affairs and City Finance reports that the Consumer Affairs and State Tax and Finance information systems are incompatible due to a lack of corresponding common information that can be used for record identification. In applying for a license, retailers are assigned different identification numbers by each agency for which they are filing an application. Neither Consumer Affairs nor Tax and

Finance record the cigarette retailer license number of the other on its information system, leaving a gap in the ability to track retailer data in either system. The audit recommends that Consumer Affairs work with Tax and Finance to identify common data elements that both agencies should include in their respective licensing information systems to facilitate the comparison of licensed retailers. Similar issues exist between City Finance and State Tax and Finance, and the audit made recommendations to improve the use of this data.

Given the joint State/City licensure requirement and the significant proportion of cigarette vendors located in the City, Tax and Finance, Consumer Affairs and City Finance should evaluate the cost/benefits of developing a joint State/City cigarette vendor license application process for retailers and a different joint process for wholesalers. Evaluation of such processes will require a significant coordination effort by each agency, including thorough analysis of current processes, laws and regulations, and information systems. However, joint State/City cigarette vendor license application processes offer the potential to greatly increase communication and organization of the licensing operation and enforcement activities, which would lead to a reduction in the illegal sale of cigarettes and increases in State and City cigarette revenues. The State and City agencies should also work closely with the State Legislature to reconcile related State and City laws in pursuing the joint license process. Among those issues that would need to be considered during this evaluation are:

Coordination of License Periods

While the State and City agencies are required to ensure the appropriate licensing of cigarette vendors, the vendors themselves are also required to ensure that the agents, wholesalers and retailers that they conduct cigarette sales transactions with are appropriately licensed. The infrequent renewal requirements and varying periods of vendor licensure currently make this verification cumbersome for the vendors, as well as for the State and City. Further, as evidenced in the audits, the current processes allow unlicensed vendors to operate illegally, resulting in a loss of State and City revenue.

Cigarette Agent and Wholesaler Licensing Structure

The State Tax Law provides the Tax and Finance Commissioner with discretion in the license renewal requirements for cigarette agents and wholesalers. For agents, the frequency of renewal cannot exceed more than once every three years; for wholesalers, the period of licensure is indefinite. Tax and Finance began an effort to renew agent and wholesaler licenses in 2002, the first renewal effort since 1988.

Although New York City does not require agents to have a City license, it does require wholesalers to obtain an annual license. A valid State license is a requirement for a City wholesale license, but broad Commissioner discretion in determining the ill-defined license period for both State wholesaler and agent licenses makes checking the license status very difficult. Since State agent and wholesaler licenses do not expire at

a predetermined time, it is difficult to structure a schedule for confirming the status of an agent or wholesaler license. The need for more definitive licensing procedures is underscored by the desire for State and City officials, as well as agents, wholesalers and retailers to easily access the most current and accurate license information to ensure compliance with laws.

Tax and Finance and City Finance officials should work together to evaluate how coordinating the period of State and City licensure for agents and wholesalers could benefit a joint licensing process, and help increase cigarette tax and fee revenues. Establishing a set term for State agent and wholesaler licenses that coincides with the City wholesale license term would enable the administrative and enforcement functions of both agencies to better develop timetables and procedures for confirming the status of licenses. Since wholesalers distributing cigarettes within the City limits must have current State licenses before obtaining a City license, establishing a coordinated license term could make the licensing process much more efficient. Coordinated periods of licensure offer the potential for better recordkeeping and facilitated identification of revoked, suspended, surrendered or expired licenses. Additionally, officials should consider changes in the licensing fee structure. In doing so, officials should evaluate the need to modify fees commensurate with a change in license duration and consider whether the current fee schedule would continue to be appropriate.

Retailer Licensing Structure

Likewise, cigarette retailer licensing between the State and City is of different durations, with the State requiring license renewal annually and City license renewal occurring biennially. Coordination of these periods between the State and the City should be evaluated by Tax and Finance and Consumer Affairs in consideration of a joint cigarette retailer license application.

Should these issues result in agreement among the agencies that the license periods should be modified, Tax and Finance should work with the Legislature to enact needed legislation.

Agreement of Common Data Elements and Terminology

As recommended in the audits, Tax and Finance and the City agencies should work to establish common data elements. In evaluating a joint State/City cigarette licensing process, appropriate consideration of common data elements is crucial. For example, currently Consumer Affairs requires cigarette retailers applying for a City license to submit proof of State licensure along with the application. However, the application does not provide a field to record the State license number and, therefore, the State license number is not on Consumer Affairs' information system. This basic piece of identifying information is one of the most important for the agencies in performing licensing and enforcement activities of retailers.

It would also be beneficial to have common data elements identifying vendor license status among the various agencies. In order to prevent the illegal sale of cigarettes, each agency must know if a vendor's license has been suspended, revoked or surrendered. Common data elements would allow an automated matching process between the various systems. Currently, however, there is no good process in place to ensure that the agencies are notified of these license-related actions. Tax and Finance has recently implemented a website containing a listing of State licensed cigarette retailers for use by wholesalers, and City Finance currently maintains a site that lists all of the current City wholesalers and agents. However, these processes lack coordination that would be beneficial in identifying this information in an efficient manner.

Likewise, enforcement of State and City Tax Laws are dependent in part on self-policing by licensed agents, wholesalers and retailers, who should determine if their business partners hold the correct licenses before conducting business with them. However, there is no method for *all* stakeholders (agencies and vendors) to access this type of information for both State and City licenses. Common data elements identifying vendor license status, which could be stored on each agency's information system, could be used to support periodic production of a web-based joint State/City license status listing. Such a listing could be used by the agencies, cigarette agents, wholesalers and retailers to help them ensure cigarette sales transactions occur only with vendors who are properly licensed. In considering these recommendations and their impact on agency information systems, creating a mechanism to automatically identify vendors that have not renewed their licenses at the end of established license terms would be another valuable step to enhance monitoring and enforcement.

Additionally, the agencies should consider the feasibility of having a common data element that identifies retailers and wholesalers as possessing a joint State/City license or State-only license. Such a data element would be useful in targeting excise tax-related enforcement activities. It may be beneficial to have this indicator on the actual license itself, as well as on each agency's information system.

Once the agencies assess and agree on common data elements and associated terminology for joint licensing processes, attention can be focused on the application forms. Not only should each application for retailers and wholesalers contain data elements beneficial to all agencies in performing licensing and enforcement activities, but the agencies should incorporate efficiencies found in some current applications. For example, the Tax and Finance license application for cigarette retailers provides retailers with multiple business locations the opportunity to register all the locations on one application.

Establishing a joint State/City cigarette vendor license could potentially improve Tax and Finance, Consumer Affairs and City Finance license processes. Should implementation of all these recommendations prove to be too burdensome, implementation should occur on an incremental basis. Furthermore, after careful consideration of these proposals, should the State and City agencies determine that the

benefits of such a process would not offset the cost of implementation, it would be appropriate to give separate consideration to each of the above proposals.

Coordination of Inspection Efforts and Enforcement Actions

As the audits report, Tax and Finance and the City agencies expend significant resources on inspection and enforcement activities to ensure compliance with both State and City tax and public health laws. Due to the similar nature of State and City laws, cigarette vendors who violate laws at one level of government are frequently in violation at another level of government, as well. The audits highlight ways in which the State and City agencies could improve enforcement through better coordination. While the agencies agreed with the audit recommendations and immediately began to take actions to enhance enforcement, additional opportunities exist through coordinated State and City agency efforts to provide even greater enforcement results and efficiencies.

Tax and Finance, Consumer Affairs and City Finance all employ processes to develop inspection and enforcement monitoring plans. Communication among agencies during the development of these plans and on an ongoing basis would provide a more comprehensive review of cigarette vendors. A coordinated inspection and enforcement approach could make it possible to review compliance and operations of a greater number of vendors, as well as focus on other areas deemed by the agencies as currently receiving less attention. Additionally, such an approach could help prevent duplication of effort. Each agency would benefit from a formalized process that keeps all three apprised of findings resulting from improved communication and better inspection and enforcement efforts.

The agencies should also identify and evaluate methods to develop stronger linkages among their information systems. By incorporating mechanisms to allow data on specific vendors that is captured by one agency to be leveraged by the other, the three agencies could enhance their current enforcement results and help to decrease the unlawful sales of cigarettes and, as a result, improve revenue collections. After inspection and enforcement reviews of vendors, the information systems could identify the date and results of such reviews, which would allow one agency to possibly target different vendors for review and/or allow another agency to take needed actions against vendors found to be in violation of laws.

Require State/City Retailer Notification of Unstamped Cigarettes

Another improvement in communication would require legislative action. When retailers purchase cigarettes from wholesalers and discover the cigarettes are either unstamped or illegally stamped, Section 473 of the State Tax Law requires the retailer to notify the wholesaler from which the cigarettes were purchased, who must replace

them with properly stamped cigarettes. Similarly, Section 11 of the New York City Administrative Code provides that retailers have 24 hours to examine cigarettes that they purchase from a wholesaler, and if the cigarettes do not have valid stamps affixed, the retailer must notify the wholesaler and arrange for the appropriate replacement within 24 hours. While the State Law and City Code benefit retailers by allowing them to ultimately obtain appropriately stamped cigarettes, there is no assurance that an unscrupulous wholesaler will not attempt to sell the improperly stamped cigarettes illegally to someone else, thus avoiding payment of State and City excise taxes.

Tax and Finance and Consumer Affairs should work together with the Legislature to amend the statute to require retailer notification of State and/or City officials when improperly stamped cigarettes are discovered after purchase. By requiring such an action, the State and City would be able to focus additional enforcement efforts on these high-risk vendors.

Improvements in cigarette enforcement have been shown to yield positive results. In 2002, Tax and Finance expanded their enforcement efforts in response to the cigarette excise tax increase that year by enacting legislation to increase the number of Tax and Finance enforcement investigators to 89. This action was successful in increasing the volume of untaxed cigarettes that were seized in the following period from 17,000 cartons to nearly 215,000 cartons.⁴² The State, City and other localities would have lost a total of nearly \$7 million in revenues had these cigarettes been sold illegally.⁴³

Appropriate evaluation and implementation of the proposals discussed above by Tax and Finance, Consumer Affairs and City Finance can also yield significant improvements in enforcement results, increasing State and City cigarette revenues and preventing the illegal sale of cigarettes in New York State.

Recommendations

The findings of the individual audits reveal a number of concerns that have increased the difficulty of enforcement actions, resulting in the illegal sale of cigarettes and a decrease in State and City revenue. There are a number of potential improvements that could make enforcement and collection processes more efficient. The following recommendations result from a combined review of both audits and should be considered to enhance the current licensing and enforcement processes. Recommendations that are unique to each agency are included in their respective audits and are detailed in Appendices A and B of this document.

⁴² Hill, Michael. "With Revenues Short, State Steps up Tobacco Tax Enforcement." *The Associated Press and Local Wire*. May 4, 2003.

⁴³ Estimate based on \$30 per carton State and City excise tax and 8 percent sales tax.

1. Tax and Finance, Consumer Affairs and City Finance should evaluate the cost/benefits of a joint State/City license application process for cigarette wholesalers and a joint State/City license application process for cigarette retailers. As part of this evaluation, the State and City agencies should:
 - consider coordinating State and City cigarette vendor license periods,
 - identify and implement common data elements that would facilitate the State and City agencies' licensing and enforcement of New York City cigarette vendors,
 - consider implementing a mechanism that would automatically identify vendors who have not renewed their licenses at the end of established license periods,
 - consider developing a joint State/City web-based license status listing for use by cigarette vendors, as well as by the State and City agencies, as a way to help restrict cigarette sales to appropriately licensed vendors (such a listing would differentiate New York City-only vendors),
 - consider application forms that build on the best practices of the current application forms of each agency,
 - consider whether the joint State/City license application processes should be implemented on an incremental basis, and
 - work with the Legislature to enact any statutory changes needed to implement these recommendations.

After careful consideration of these proposals, should the State and City agencies determine that the benefits of such a process would not offset the effort or cost, it would be appropriate to give separate consideration to each proposal noted above.

2. Tax and Finance, Consumer Affairs and City Finance should consider coordinating inspection and enforcement planning and reporting resources to allow increased compliance and operational review of cigarette vendors, improve focus on areas currently receiving less attention and help prevent duplication of effort.
3. Tax and Finance, Consumer Affairs and City Finance should work together to identify and evaluate stronger linkages between their information systems, such as allowing the transfer of vendor data among agencies to enhance current enforcement practices, decrease the unlawful sale of cigarettes and improve revenue collections.

4. Tax and Finance and Consumer Affairs should work together with the Legislature to amend the State Tax Law to require State and/or City notification by retailers when improperly stamped cigarettes are discovered after purchase from wholesalers, allowing additional enforcement efforts of these high-risk vendors.

Department of Taxation and Finance, Selected Controls Over Cigarette Licensing and Excise Taxes (2002-S-58)

Recommendations

1. Expedite the development of the website for wholesalers to use to confirm that retailers possess a valid Certificate of Registration.
2. Develop written procedures which require the Taxpayer Services and Revenue Division to provide both enforcement and licensed wholesalers with information identifying retailers who have not renewed their cigarette registration.
3. Continue to follow up on and investigate the exceptions disclosed during our visits to selected retailers and, as appropriate, impose penalties on those retailers in violation of the Law.

(Tax and Finance officials agreed with these recommendations and indicated some have been implemented.)⁴⁴

4. Follow up with agents, wholesalers and retailers who failed to file or filed zero-dollar return but had inventory on hand as of Tax and Finance's physical inventory counts.
5. Investigate all large discrepancies between Tax and Finance's calculated potential liability and the actual amount of remittance.

(Tax and Finance officials agreed with our recommendations, but disagreed with our characterization of the administration of the "floor tax" issue. They stated that the issue was still being worked upon at the time of our audit. Therefore, it is unfair to judge their efforts prior to completion.)⁴⁵

6. Develop and provide formal written procedures to the Transaction and Transfer Tax Audit Bureau's Midwestern Regional Office (MRO) auditors for monitoring the stamp production and shipment process. Conduct periodic visits to Meyercord to determine whether MRO auditors are complying with procedures.

⁴⁴ Office of the State Comptroller, *Department of Taxation and Finance, Selected Controls Over Cigarette Licensing and Excise Taxes*, Report 2002-S-58, October 2003, p. 6.

⁴⁵ Office of the State Comptroller, *Department of Taxation and Finance, Selected Controls Over Cigarette Licensing and Excise Taxes*, Report 2002-S-58, October 2003, p. 9.

7. Work with Fleet officials to develop formal written procedures for managing the tax stamp inventory at Fleet's six emergency sites.⁴⁶ Conduct periodic site visits to determine whether the stamp inventory is accounted for and properly managed in accordance with procedures.
8. Require Fleet to maintain records that accurately show the name of the stamp custodian at each emergency site.

(Tax and Finance officials agreed with recommendations six and eight. However, they disagreed with recommendation seven, stating that procedures did exist for managing the tax stamp inventory at the emergency sites.)^{47 48}

⁴⁶ Fleet is required to maintain tax stamp storage sites throughout the State. Tax stamp inventories are maintained by Fleet at these sites in the event of an emergency, such as a stamp shortage.

⁴⁷ Office of the State Comptroller, *Department of Taxation and Finance, Selected Controls Over Cigarette Licensing and Excise Taxes*, Report 2002-S-58, October 2003, p. 12.

⁴⁸ Office of the State Comptroller, *Department of Taxation and Finance, Selected Controls Over Cigarette Licensing and Excise Taxes*, Report 2002-S-58, October 2003. In response to this comment, the report noted in Appendix C, State Comptroller's Notes, Note 5 that "Subsequent to the issuance of our draft report, on October 1, 2003, Tax and Finance provided us with a copy of procedures from the Transaction and Transfer Tax Audit Bureau. However, during our on-site visits to the six emergency locations, we asked each operation manager for copies of the written procedures they use to manage the tax stamp inventory. In each instance, the managers responded that they did not have any formal written procedures. In addition, when Tax and Finance responded to our preliminary finding document on March 12, 2003, they stated, "We agree to work with Fleet to implement formal written procedures for the six emergency sites." Therefore, we do not accept that valid, formal procedures were in place at the emergency sites."

New York City Department of Consumer Affairs/New York City Department of Finance, Selected Controls Over Licensing of Cigarette Retailers and Wholesalers (2003-N-7)

Recommendations

To Consumer Affairs:

1. Work with Tax and Finance officials to establish a list of common data elements to be included in the respective licensing databases to facilitate matching. At a minimum, update the current database to include the sales tax registration number and State registration number when retailers renew their licenses. Confirm the accuracy of this information with Tax and Finance for retailers who renew their license.
2. Compare the Consumer Affairs cigarette retailer license database to Tax and Finance database on a regular basis to identify retailers who do not have both the current State registration and a New York City license. Use the results of these comparisons to target retailers for appropriate enforcement actions.
3. Follow up on all retailers identified in our samples as not in compliance with the cigarette licensing laws and take appropriate actions.
4. Work with Tax and Finance officials to develop a process to verify that license applicants have a current State registration after the issuance of the New York City license.
5. Develop a plan for Consumer Affairs enforcement efforts that includes the use of the techniques, such as those demonstrated in this audit, to identify retailers for enforcement efforts. Among other things, this should include periodically notifying licensed wholesalers of those New York City retailers whose licenses were suspended or revoked.
6. Work with Tax and Finance officials to identify formal ways to share specific enforcement actions (suspensions, revocations) between agencies.

(Consumer Affairs officials agreed to implement all six recommendations.)⁴⁹

⁴⁹ Office of the State Comptroller, *New York City Department of Consumer Affairs, New York City Department of Finance, Selected Controls Over Licensing of Cigarette Retailers and Wholesalers*, Report 2003-N-7, June 2004, p. 17.

To Finance:

7. Request Tax and Finance to notify City Finance when a cigarette wholesaler's State license is revoked or suspended. In turn, City Finance should notify Tax and Finance when a wholesaler's New York City cigarette license is revoked or suspended.
8. Establish formal written procedures for the wholesale cigarette license review and approval process.
9. Prepare a long term strategic plan for the City Finance enforcement operations that would employ a variety of approaches, including a comparison of Tax and Finance and City Finance records to identify potential unlicensed wholesalers.

(City Finance officials agreed to develop ways to implement all three recommendations.)⁵⁰

⁵⁰ Office of the State Comptroller, *New York City Department of Consumer Affairs, New York City Department of Finance, Selected Controls Over Licensing of Cigarette Retailers and Wholesalers*, Report 2003-N-7, June 2004, p. 21.

Major contributors to this report included:

Christine Rutigliano	Assistant Comptroller
Gabriel Deyo	Assistant Director
Steven Elliott	Assistant Director
Thomas Milner	Policy Research Analyst
Joseph Rutherford	Policy Research Analyst
Kathleen Kerwin	Research Assistant