A REPORT ON NEW YORK CITY'S TAR AND NICOTINE TAX, BASED ON CONSUMPTION DATA FOR THE FIRST TWELVE MONTHS FOLLOWING ITS IMPOSITION

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The New York State Commission of Investigation stated at the conclusion of its public hearing into the bootlegging of cigarettes into New York City and State by elements of organized crime:

> "It is undisputed that the heart of the entire problem lies in the wide disparity between the price of a package of cigarettes in some Southern states, such as North Carolina, and in New York City. The price here is almost double. This price disparity has nurtured a flourishing smuggling business whereby innumerable unlawful independent quick-profit seekers and organized criminal elements import and distribute huge quantities of untaxed cigarettes to an insatiable public, eager to buy low cost cigarettes."

The imposition of the New York City tar and nicotine tax on July 1, 1971 further increased this price differential. As a result, the incentive and profit for organized crime to bootleg cigarettes has been increased. This particular tax has also further complicated the process of taxing and distributing cigarettes for the legitimate cigarette retailers, vendors and wholesalers. Between the increased cigarette bootlegging and the additional problems involved in cigarette taxation and distribution, the continued existence of the legitimate cigarette industry in New York City and State is questionable.

I. Effects of the tar and nicotine tax on New York State

In the first twelve months following the imposition of the New York City tar and nicotine tax, cigarette sales in New York State declined 2.1 percent. This decline means that in addition to the 400-million packs of cigarettes being bootlegged annually into New York State by organized crime as confirmed by the State Invstigation Commission, another 46 million packs will be smuggled into the State as a result of the tar and nicotine tax. The State, at its present tax rate of 15 cents per pack, will lose some $7 million per year because of the City's tax.

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II. Effects of the tar and nicotine tax on New York City

New York City estimated that the tar and nicotine tax would result in revenues of $20 million annually. This, however, has not been the case. Since the imposition of the tax, cigarette sales in New York City have declined 11.7 percent, costing the City some $4 million in lost revenues from its $.04 excise tax on cigarettes. In addition, both the City and State have lost a total of $2.5 million in sales taxes on cigarettes. Therefore, adding all the City and State losses together, 13.5 million, the New York City tar and nicotine tax has only net $6.5-million to the two governmental agencies. Even this gain, however, will be further offset by the increased administrative problems associated with enforcement and collection of the tax.

III. Effects of the tar and nicotine tax on organized crime

The State Commission of Investigation clearly indicated at its hearings that tax differentials on cigarettes between states is the primary incentive for the involvement of organized crime in cigarette bootlegging. The fact that cigarette sales in New York State have declined by 2.1 percent -- 11.7 percent in New York City -- at a time when national sales have increased 2 to 3 percent, indicates that organized crime has taken advantage of the increased tax differentials caused by the tar and nicotine tax, and is bootlegging even greater quantities of cigarettes into New York City and State. Organized crime, based on conservative estimates, makes a net profit of $1.00 per carton on bootlegged cigarettes. Therefore, on the additional 46 million packs being bootlegged into the State, organized crime has made profits of $4.6 million. There is no doubt that organized crime has been the primary beneficiary of New York City's tar and nicotine tax.

IV. Effect of the tar and nicotine tax on the legitimate cigarette trade in New York City and New York State

Since 1965, the tobacco industry in New York State has lost over 2.2 billion packs in cigarette sales to cigarette bootleggers, worth over $1.1 billion in gross retail sales. This loss of cigarette volume also indicates that fewer shopping trips were made to cigarette retailers and, as a result, additional losses were incurred in the sale of allied products such as candy, tissues, razor blades and thousands of other sundries. The very existence of the legitimate cigarette trade in New York City and State has been seriously threatened by the tar and nicotine tax.

V. Effect of the tar and nicotine tax on cigarette jobbers

In view of the complexity of the new tax structure, problems arise at the source of collection, namely, at the cigarette jobbers. Prior to the imposition of the new tax, all packs were taxed equally. The only tax records required were those limited to the total number of packs sold. The new 0 to 4 cent tar and nicotine tax has changed all this. Sales records on all brands, by item within brand, are now required to establish the proportion of sales falling within each tax group (0,3, or 4¢). As a result of the new and detailed record-keeping, many problems have cropped up at the jobber level not the least of which, is the considerable possibility for error. This, in turn, has led to problems between City administrators and cigarette jobbers regarding the computation and payment of the tax.

Further problems will arise on a continuing basis since the tax rates are based on the official estimates of tar and nicotine content published by the Federal Trade Commission. These estimates are updated

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periodically and it is possible , if not probable, for a brand type to switch from one tax group to another in a matter of months. Keeping track of and implementing these changes has proved, and will continue to prove, an additional complication to consumers, retailers, jobbers and City administrators alike.

In additon, the fact that certain cigarette manufacturers now charge different prices for the same size cigarettes further complicates the cigarette jobber's bookkeeping. This new pricing trend might also nullify the intended impact of the tar and nicotine tax.

VI. Effect of the tar and nicotine tax on retailers

Since the imposition of the tax, New York City retailers have had to reorganize their entire pricing structure. Prior to the tax, virtually all cigarettes sold by the pack were identically priced, and carton prices were largely comparable within size type. Where a price differential did exist, it was based largely on the length of the cigarette and, hence, was readily distinguishable. Now, with the new tax increments, prices of cigarettes differ not only by length, but also by tar and nicotine content. Obviously, a price structure incorporating an additional dimension such as this is not readily learned by the person at the point of sale, i.e., the sale's clerk. The fact that types within brands often differ as to tar and nicotine content--a menthol might differ from a "King" or a soft-pack might differ from a box--and the fact that individual brand types often shift tax groups, further complicates any attempt to train retail sales personnel to learn and apply the tax differentials.

Because of these difficulties inherent in the tar and nicotine tax, the tax has failed in its intended purpose--influencing brand selection. The problems associated with attempting to distinguish between the

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