



STATE OF NEW YORK
NEW YORK STATE SENATE

STANDING COMMITTEE ON INVESTIGATIONS
AND GOVERNMENT OPERATIONS

SENATOR CRAIG M. JOHNSON
Chairman

Executive Refusal

**Why the State Has Failed to
Collect Cigarette Taxes on Native
American Reservations**

June 2010

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Executive Refusal

Why the State Has Failed to Collect Cigarette Taxes on Native American Reservations

I. Introduction

New York currently faces an economic crisis, the likes of which haven't been seen for decades. The current budget shortfall in excess of \$9 billion dollars has forced state lawmakers to confront an array of difficult decisions involving budget priorities. To stave off even further devastating reductions, the Legislature has looked to additional revenue generating sources that would not further unfairly burden the already hard pressed New York taxpayer.

One source of additional revenue available to New York State consists of monies generated on Native American reservations through the sale of cigarettes and gasoline to Non-Native Americans. Public consideration of this tax collection initiative has generated some very strong opinions. These reactions are unsurprising given the often tenuous and complex relationship between New York State and its Native American Nations.

When this sentiment is considered in light of New York's fiscal situation, we are left with an extremely delicate and understandably emotional conflict. New York State relies on taxation of cigarettes to raise revenue and discourage smoking. A sizable portion of this tax revenue has been lost due to the sale of cigarettes and gasoline on Native American reservations throughout the state.

New York has pursued a dyslectic two-track approach to the collection of cigarette taxes on Native American reservations. On the one hand, the State voices its intent to collect taxes on sales by Native American retailers to non-Native Americans (and even success-

fully litigated the issue when legal challenges arose). Then, in a striking failure of governmental determination, Governor George E. Pataki's administration essentially ceded tax collection power by adopting a "forbearance policy" that eschewed collection of this tax. This policy was adopted in 1997 after the State faced threats and experienced violence during its efforts to collect the tax. State property was damaged and State Troopers were injured during altercations involving Native American Nation members. Governor Pater-son has continued this embarrassing policy through failed negotiations and lack of will.

Consumer demand eager to discover and access low cost cigarettes was created as New York State continuously raised its cigarette tax rate to record levels. New Yorkers, in increasing record numbers, turned to the Internet and Native American "smokeshops," as alternatives to paying the higher cigarette prices. As Native Americans and Internet retailers grew in number and sales volume, licensed wholesalers and retailers, particularly those located near Native American smokeshops, found themselves increasingly unable to compete and went out of business. Simply put, New York State created, and Native Americans took advantage of, an economic vacuum. Responsibility for these dire economic consequences inextricably rests firmly with the Governor's office.

Relations between New York and the Native American Nations are tense, with both sides contending the other has failed to honor its promises. With an understanding of the sensitive nature of this issue, the Senate Standing Committee on Investigations and Government Operations (the "Committee") initiated an investigation in the Fall of 2009 to explore the history of the collection of taxes on reservations and ways to bring the State and tribes closer to a solution to this long-standing problem.

The hearings were held to shed light and focus attention on a policy of governmental fiscal impotence and failed leadership. The goal is to craft a workable solution that will result in fairly, and lawfully, collecting revenue which fund essential services vital to all New Yorkers.

II. History

There has been a centuries-long struggle between the Native American nations and New York State. Questions of land claims and health and welfare policy have dominated the nearly 400-year relationship between Native American Nations and New York. This situation is neither unique nor confined to New York alone. The United States Supreme Court observed "the relation of the Indian tribes living within the borders of the United States both before and since the revolution, to the people of the United States has always been an anomalous one, and of complex character."¹ The past thirty years have witnessed this tension revolve around the issue at hand, the collection of cigarette and gasoline taxes from transactions by non-Natives on Native American reservations.

¹ United States v. Kagama, 118 U.S. 375, 381 (1886).

During the October 2009 hearing, the Seneca Nation of Indians (the “Seneca Nation”) provided the Committee with materials that reviewed the historical grievances. These documents portray a compelling history. Understanding the full history of New York – Native American relations is extremely important to this Committee and a solution to the revenue issue cannot be found until the past is appropriately understood. Two specific treaties, the Treaty with the Six Nations, generally known as the Treaty of Canandaigua (the “Canandaigua Treaty”) and the Treaty with the Seneca, known as the Second Buffalo Creek Treaty (“Buffalo Creek Treaty”), are the two treaties cited by those tribes claiming the state is unable to collect taxes on cigarettes sold on reservations. The details of these treaties will be discussed later.

The relationship between Native Americans and the State, however, goes beyond 18th and 19th century treaties. New York State law mandates several state agencies, such as the Office of Children and Family Services and State Education Department provide certain services to Native Americans. Programs such as the Department of Health’s American Indian Health Program provide New York Native Americans with primary care coverage, prescription drugs, and access to hospital services.² Native Americans are also eligible for Medicaid.³ The State Department of Education’s Native American Unit contracts with schools throughout the state to provide education for reservation children.⁴ Additionally, Native American students in New York are eligible for the Tuition Assistance Program (TAP) and annual \$2000 grants.⁵

More recently, gaming compacts have been agreed upon between New York State and Native American nations. With the signing of a casino compact with the State, several Seneca casinos were opened in western New York State, including a major casino hotel complex in Niagara Falls. There are currently Class III gaming compacts between the State and the Seneca Nation, the Oneida Indian Nation of New York and the St. Regis Mohawk Tribe. These compacts provide casino operation standards and specifications. They also address casino public safety, and require the State Police to fingerprint and conduct employee background checks.⁶

The Committee recognizes that the State must honor previous treaties and compacts with native tribes. After a full and fair reading of history, it would be intellectually dishonest to conclude otherwise. That being noted, New York public policy makers have made decisions regarding taxation of cigarettes based on both budgetary and public health concerns.

The purpose of this investigation has been to study the facts, history and the law to offer fair and objective criticism and solutions.

2 http://www.health.state.ny.us/community/american_indian_nation/

3 http://www.nyhealth.gov/health_care/medicaid/publications/docs/gis/05ma028.pdf

4 <http://www.emsc.nysed.gov/rss/natamer/studentaidinfo.html>

5 Social Services Law §39 and Education Law Art. 83.

6 See e.g., “Nation-State Gaming Compact Between the Seneca Nation of Indians and the State of New York;” Tribal-State Compact Between the St. Regis Mohawk Tribe and the State of New York” and the “State Compact Between the Oneida Indian Nation of New York and the State of New York.”

III. The Legal Landscape

Both the Federal and State governments have long recognized the legal doctrine of “tribal sovereignty” – i.e., the right of Native American tribal nations to exercise their inherent power to govern their own internal affairs. Accordingly, New York State recognizes that it may not enact laws that interfere with tribal self-government.⁷ However, states are not powerless to pass legislation and enact regulations that affect their non-Native Americans’ conduct while present on tribal lands. This includes persons engaging in commercial transactions with Native American merchants.

Native American nations are not viewed the same way as foreign nations. The U.S. Constitution’s Commerce Clause differentiates between “foreign nations” and “Indian tribes” empowering Congress “to regulate commerce with foreign Nations and among the several states, and with the Indian tribes.”⁸ In the absence of federal statutes or treaties, federal and state court cases recognize that states like New York may lawfully collect taxes on purchases made by non-Native Americans from Native Americans and collect taxes on income earned by Native Americans who live, or are employed, off reservations.⁹

State taxation of tribal sales of cigarettes to non-tribe members is not pre-empted by federal law. The United States Supreme Court has consistently held that states may tax the sale of these products to non-native Americans.¹⁰ The Supreme Court and other federal courts have upheld efforts by various states to enforce various taxing mechanisms.¹¹

Similarly, the New York Court of Appeals also concluded that New York State is well within its rights to impose sales taxes to reservation cigarette sales to non-Native Americans and non-member Native Americans.¹² State courts, however, have also upheld New York State’s right not to enforce the collection of such taxes.¹³

Most recently, a divided Appellate Division, Fourth Department held that cigarette tax sales could not be taxed under section 471 of the Tax Law because Tax Law section 471-e was expressly designed to provide a single statutory basis for taxing reservation cigarette sales.¹⁴ The appellate court concluded that since section 471-e was not operational, and the affected tribe could not be taxed under section 471, no tax could be validly imposed.

7 Indian Law, § 6; *Fellows v. Dennison*, 23 N.Y. 420, 425 (1861) rev’d other grds. 72 U.S. 761 (1866)

8 U.S. Const., Art. I, § 8.

9 *Worcester v. Georgia*, 31 U.S. 515 (1832); *United States v. Holiday*, 70 U.S. 407, 417 (1866). See also *St. Regis Tribe v. State of New York*, 5 N.Y.2d 24, 38 (1958).

10 See, e.g., *Department of Taxation and Finance of New York v. Milhlem Attea & Bros., Inc.*, 512 U.S. 61, 73-75 (1994); *Washington v. Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134, 158 (1980); *Moe v. Confederated Salish & Kootenai Tribes of Flathead Reservation*, 425 U.S. 463, 482-83 (1976).

11 See, e.g., *Milhelm Attea & Bros., Inc.*, 512 U.S. at 73-78 (upholding New York State’s tax exemption coupon system); *Colville*, 447 U.S. at 159-60 (upholding sales tax and collection record keeping requirement); *Moe*, 425 U.S. at 482-83 (enforcing Montana law requiring tribal merchant to sell tax-stamped cigarettes to non-native customer); *Keweenaw Bay Indian Cmty v. Rising*, 477 F.3d 881, 892 (6th Cir. 2007) (validating Michigan law concerning non-Native American tobacco sales); *City of New York v. Golden Feather Smoke Shop, Inc.*, No. 08-CV-3966, 2009 WL 2612345 (E.D.N.Y. Aug. 25, 2009) (enjoining Native American tobacco retailers from selling unstamped cigarettes to non-Native Americans).

12 *Snyder v. Weltzer*, 84 N.Y.2d 941, 942 (1994).

13 *Day Wholesale, Inc. v. New York*, 51 AD3d 383, 856 N.Y.S. 2d 808 (3rd Dept. 2008); *New York Assn. of Convenience Stores v. Urbach*, 275 A.D. 2d, 520 (3rd Dept. 2000).

14 *Cayuga Indian Nation of New York v. Gould*, 66 A.D.3d 100, 884 N.Y.S.2d 510, 516-517 (4th Dept. 2009).

In her dissent, Justice Peradotto observed that the purpose of section 471-e was not to impose a tax but rather serve as the “statutory mechanism for the collection of that tax from reservation sales to non-Indians and non-member Indians.”¹⁵ Importantly, the obligation to pay, and liability to impose, the sales tax remained unaffected by section 471-e.¹⁶ This case was orally argued before the Court of Appeals on March 25th, and decided on May 11, 2010. The Court, in a sharply divided 4-3 decision, ruled that until a “legislative or regulatory scheme” was implemented in order to enforce Section 471, the Native Americans could not be criminally charged for not collecting taxes on sales of cigarettes on reservations to non-Native Americans.¹⁷

Treaties

Native American Nations have voiced legitimate concerns about entering into agreements with New York State. History has shown that land deals can be especially burdensome and costly for the Nations. The Federal Government acquired 9000 acres of Seneca land for the construction of the Allegheny River Kinzua Reservoir. The Mohawks had land taken in connection with the construction of the St. Lawrence power project, and the Reynolds Aluminum and General Motors plants. The Niagara River power project cost the Tuscarora Nation hundreds of acres of land.¹⁸

Treaties between the United States government and Native American Nations, such as the Canandaigua Treaty and Buffalo Creek Treaty, were implemented to protect Native American lands.¹⁹ The Seneca Nation has cited these treaties as the basis for its contention that New York State lacks authority to collect taxes on its reservations.²⁰

The Seneca Nation believes these treaties uphold the basic premise of U.S. – Native American relations that “our lands belong to the Seneca Nation and the Seneca people and that no other government has the right to interfere in how we use those lands.”²¹ The Buffalo Creek Treaty provides that the United States will “protect such of the lands of the Seneca Indians within the State of New York as may, from time to time, remain in their possession from all taxes and assessments for roads, highways or any other purpose until such lands shall have been sold and conveyed by said Indians, and the possession thereof shall have been relinquished by them.”²² The Canandaigua Treaty acknowledges that certain lands are “the lands of the Seneca Nation” and provides that the United States “will never claim the same, nor disturb the Seneca Nation, nor any of the Six Nations, or of their Indian

¹⁵ Gould, 884 N.Y.S.2d at 519 (emphasis added).

¹⁶ *Id.* at 523.

¹⁷ *Cayuga Indian Nation v. Gould*, __ N.Y.3d __, N.Y.L.J. 5/12/10.

¹⁸ Testimony of Robert Porter (“Porter Testimony”), October 27, 2009, at p. 142.

¹⁹ While this treaty was never ratified by the United States Senate (see *Seneca Nation v. Christie*, 126 N.Y. 122, 128-130 [1891]), it has been respected.

²⁰ Testimony of J.C. Seneca (“Seneca Testimony”), October 27, 2009 at p. 182.

²¹ *Id.* at p. 184.

²² Treaty with the Seneca, May 20, 1842, 7 Stat. 586, Art. 6.

friends residing thereon, and united with them, in the free use and enjoyment thereof; but it shall remain theirs, until they choose to sell the same, to the people of the United States, who have the right to purchase.”²³

The Committee finds unpersuasive the assertions that the Buffalo Creek Treaty and the Canandaigua Treaty precludes New York State’s ability to impose and collect taxes on the sale of cigarettes and gasoline to non-Native Americans. Neither treaty specifically addresses, nor prevents, the State from collecting cigarette taxes.²⁴ “[I]f a state tax or regulation is not preempted by federal law and is not inconsistent with tribal self government, it can be applied to economic activity on tribal land.”²⁵

More significantly, both federal and New York state courts have concluded that the Buffalo Creek treaty cannot be utilized as a basis to preclude sales tax liability or collection.²⁶ “The [Buffalo Creek] Treaty although it prohibits the State from taxing reservation land, does not bar the imposition of excise and sales tax on cigarettes and motor fuel sold to non-Indians on the Seneca Nation’s reservations.”²⁷ Similarly, The U.S. Court of Appeals, Second Circuit also concluded that the Buffalo Creek Treaty “clearly prohibit[s] only the taxation of real property, not chattels like cigarettes.”²⁸

The Canandaigua Treaty also does not preclude New York State’s cigarette tax collection efforts. This treaty says nothing about taxation as it did not focus on taxation. Rather, the treaty was “one of peace and friendship between the United States and the Indians.”²⁹ In fact, the Canandaigua Treaty does not preclude the application of excise taxes.³⁰

Recent Legislation

In 2000, New York State passed the first law of its kind in the nation prohibiting the direct shipment of untaxed cigarettes to consumers, in an effort to reduce the internet trade in untaxed cigarettes and prevent remote sales to minors. That law, written by Senators Jeffrey Klein and Charles Fuschillo, now bans common carriers from delivering untaxed cigarettes to New York consumers.³¹ In this light, New York has also been a leader in negotiating a multi-state agreement with credit card issuers to stop processing payments for illegal shipments of untaxed cigarettes. Unable to deliver by common carrier or accept credit card payments, the mail order trade in untaxed cigarettes has been substantially curbed, but not eliminated.

23 Treaty with the Six Nations, Nov. 11, 1794, 7 Stat. 44, Art. 3.

24 Treaty with the Six Nations, Nov. 11, 1794, 7 Stat. 44, Art. 3.

25 *Id.* at pp. 44-45.

26 *Snyder v. Wetzler*, 193 A.D.2d 329 (4th Dept. 1993), *aff'd*, 84 N.Y.2d 941 (1994) (determining that treaty “clearly refers only to taxes levied upon real property or land.”).

27 *New York State Department of Taxation & Finance v. Bramhall*, 235 A.D.2d 75, 85 (4th Dep’t 1997); See also *Briffault Testimony*, 1/26/10 at p. 57 (“The treaty was plainly intended to prevent recurrence of assessments on land, but it says nothing about and has no bearing on a sales tax which is not a tax on land.”).

28 *United States v. Kaid*, 241 Fed. Appx 747 (2nd Cir. 2007).

29 *People of the State of New York ex. Rel. Ray v. Martin*, 326 US 496, 500 (1946).

30 See, e.g., *Cook v. United States*, 32 Fed. Cl. 170 (1994) (rejecting claim that treaty created exemption from federal excise tax on storage and sale of diesel fuel).

31 Chapter 262 of the Laws of 2000.

Federal legislation was enacted earlier this year to finally shut down the internet trade in untaxed cigarettes by closing the remaining loophole that allows the United States Postal Service to deliver cigarettes to New York consumers. President Obama signed the Prevent All Cigarette Trafficking Act (PACT) on March 31, 2010.³²

IV. Economic Considerations

New York State convenience store owners pay a license fee to sell tobacco products and comply with the myriad of regulations surrounding tobacco sales.³³ Cigarette sales are a core product of the convenience store product line. These retailers provide employment, risk capital, and work seven days a week. Nevertheless, these small business owners are confronted with a State policy which chases their customers away to tax free retailers against whom they cannot possibly compete.³⁴

Nationally, cigarette sales account for thirty to thirty-five percent (30-35%) of sales for a typical convenience store.³⁵ Recently, this state's convenience stores have experienced a 2/3 to 3/4 decline in cigarette sales volume.³⁶ Although the sales drop is partially attributable to a decline in consumption, much of the loss in sales has been driven by a quintupling of the cigarette excise tax during the past eight years combined with the state's failure to close off established tax evasion channels of Native American sales to non-Native Americans, Internet sales and illegal bootlegging.³⁷ Due to the expansion of the Native American smokeshops, and Internet sales, the number of cigarette wholesale licenses issued by the Department of Taxation and Finance has declined from 751 in 1996 to 286 in 2008, and the number of retail licenses declined from 29,401 in 2007 to 26,981 in 2009.³⁸ The sale of cigarettes bearing New York State tax stamps declined by 75% between 1984 and 2008.³⁹ By contrast, the shipment of cigarettes to Native American reservations has substantially increased, the highpoint occurring in 2005, which witnessed a 2,500% increase in cigarette traffic to these reservations.⁴⁰

The tax evasion epidemic cripples small business, squanders desperately needed tax revenue, and thwarts anti-smoking initiatives. For instance, cigarette sales at 7-Eleven franchises across New York City, Nassau and Suffolk counties and upstate New York have plummeted due to high federal and state excise taxes.⁴¹ 7-Eleven stores in Shirley, Long Island have almost no cigarette sales due to their close proximity of the Poospatuck Tribe Reservation.⁴² These stores' customers purchased their cigarettes either at the Mastic Indian Reservation or online.⁴³

32 Public Law 111-154.

33 Testimony of Jim Calvin ("Calvin Testimony") January 26, 2010, at p. 19.

34 Id.

35 Id.

36 Id.

37 Id. at p. 20.

38 Email from William Comiskey to Roger Adler, March 16, 2010.

39 Written Testimony of William Comiskey ("Comiskey Written Testimony"), at Appendix A-4

40 Id.

41 Testimony of Jack Rugan ("Rugan Testimony"), October 27, 2009 at p. 320.

42 Id. at p. 321.

43 Id.

Each tax free purchase of a pack of cigarettes deprives the State of \$2.75 in excise taxes. State and Local governments lose another fifty cents in sales tax revenue. Licensed retailers also lose legitimate sales, costing billions in revenue, jobs and community reinvestment.⁴⁴ Major conflicts exist regarding the amount of tax revenue lost to the state due to the sales of cigarettes to non-Native Americans on Native American reservations.

A March 2009 study by economist Dr. Brian O'Connor concludes that tax collection of such sales tax revenue would generate around \$1 billion annually for New York State.⁴⁵ Others estimate that the figure is \$1.6 billion in lost tax revenue.⁴⁶ Still others peg the lost revenue figure to be approximately \$830 million per year.⁴⁷

The Tax Department comes in on the low end of a revenue forecast. It estimated that the forbearance policy annually costs \$200 million in lost tax revenues.⁴⁸ Deputy Commissioner William J. Comiskey, in his testimony, disputed the higher loss figures, suggesting that a \$1 billion annual estimate "missed the mark" because they ignore out-of-state internet sales.⁴⁹

The Tax Department's \$200 million appears to be extremely conservative and is contradicted by other New York State government positions. In 2006, New York State's Department of Health ("DOH") issued a cigarette report. DOH estimated the revenue lost to the State as a result of New Yorkers buying untaxed cigarettes as between \$436 and \$576 million.⁵⁰ This amount was determined when the tax on cigarettes was \$1.50. Given the 2008 tax increase to \$2.75 a pack, the revenue loss likely only increased. Accordingly, it is likely that New York State's coffers would see more than the Tax Department's \$200 million revenue number.

Regardless of the conflict in numbers, it is indisputable that New York State's finances are entitled to this much needed revenue, and is in sore need for such revenue. New York State's economy is not the only one impacted by the forbearance policy. Municipalities, such as upstate counties and New York City suffer due to this policy. In October, the Committee heard testimony from David Dresser (Supervisor, Seneca County), S. John Campanie (Madison County Attorney), and Peter Same (Supervisor, Town of Seneca Falls). These three witnesses appeared collectively as a panel, and articulated the economic plight localities confront as a consequence of lost cigarette tax revenue. Local taxpayers are being squeezed and social services suffer because of reduced tax collection.

Native American nations contend that it is New York's own fault that its citizens are entitled to purchase tax free cigarettes because of the increase in cigarette taxes. The Sen-

44 Calvin Testimony at p. 20.

45 *Id.*, at pp. 24-25.

46 Testimony of Steve Rosenthal (Rosenthal Testimony), October 27, 2009 at p. 82.

47 Testimony of Russ Sciandra (Sciandra Testimony), October 27, 2009 at p. 316.

48 Comiskey Testimony at p. 26.

49 *Id.* at pp. 26-27.

50 "Cigarette Purchasing Patterns Among New York Smokers: Implications for Health, Price, and Revenue." New York State Department of Health, March 2006, at p. v.

eca argue that State officials were “ignorant of Indian treaty rights,” and believed that the State had exacerbated its own economic problems by constantly raising cigarette taxes, thus luring consumers to seek cheaper alternative outlets to purchase cigarettes.⁵¹ While admitting that New Yorkers have been driven to buy their cigarettes on Native American reservations, the Seneca vehemently deny that hundreds of millions (and even billions of dollars) are being diverted from the State’s coffers. “This assessment is untrue and misleading. And the continued efforts to promote this lie by our critics is scapegoating and worse.”⁵² On the contrary, the Senecas contend that their western New York businesses inject over \$1.1 billion into the local economy.⁵³ A study conducted by Harvard economist Jonathan Taylor revealed that New Yorkers who buy gas and cigarettes on Native American reservations, in fact, spend their savings in New York State.⁵⁴

In addition to the lost cigarette tax revenues, New York is losing revenue from lack of payment for services provided under current gaming compacts. Under existing casino compacts, the Seneca, St. Regis Mohawk, and Oneida are obliged to pay for State services. Native Americans have generated payment balances to the State of close to \$56 million in casino related fees and revenues.⁵⁵ There have been many disputes among these parties due to differing interpretations over casino payment obligations.⁵⁶ There are ongoing discussions which may lead to arbitration of these payment disputes. The disputed funds have been placed in escrow pending a resolution.⁵⁷

Determining an exact amount of sales tax revenue is nearly impossible. It cannot be disputed, however, in the years since the Attea case the state and local economies have lost billions of dollars due to the lack of tax collection. The loss figure is actually higher, if the unknown loss of petroleum sales, and sales tax on other products was collected.

V. Forbearance

The State’s authority to collect taxes generated by the sale of cigarettes from Native American smokeshops has been upheld by the Courts. Nonetheless, the State has failed to collect these tax revenues. This policy of forbearance, dates back to the 1990’s and continues to this day regardless of the Governor’s political affiliation. Forbearance has had both legal and economic consequences. New York courts have judicially recognized the Executive Branch’s discretion to refrain from collecting sales and use taxes on products sold by tribal retailers to non-Native Americans.⁵⁸ For instance, courts have determined that New York State’s method of collecting this sales tax under section 471-e cannot become effective until New York State ceases its policy of withholding the distribution

51 Seneca Testimony at p. 186.

52 *Id.* at p. 192.

53 *Id.* at p. 187.

54 *Id.* at p. 249.

55 State Police chart provided by Governor’s counsel via letter, January 20, 2010.

56 Testimony of Peter J. Kiernan, Esq. (“Kiernan Testimony”), October 27, 2010 at p. 133.

57 *Id.* at pp. 133-134.

58 *New York State Convenience Association of Convenience Stores v. Urbach*, 92 N.Y.S.2d 204 (1998).

and use of tax exemption coupons.⁵⁹ The pattern of withholding the tax free coupons has continued uninterrupted to date as has the failure to collect the excise tax on cigarettes on sales to non-native Americans.

The tax exempt coupons are ready for distribution and draft regulations have been prepared.⁶⁰ The vouchers, however, have not been distributed pursuant to the statute in conformity with an advisory opinion issued during the Pataki Administration.⁶¹ Taxation and Finance has requested permission from the Paterson Administration to distribute the tax exempt coupons. That permission, however, has not been granted. In his 2010 budget presentation, Governor Paterson once again stated that the forbearance policy would end and the taxes would be collected. In March, regulations were issued and a six month public comment period began. The Committee does not believe the Executive Branch will actually follow through with this proposal. We have heard this story before to no avail.

Concerning the issue of executing Tax Law § 471 to sales by Native Americans to non-Native Americans, Peter J. Kiernan, Esq. testified that the application of this law remains subject to frequent review, requiring a broad and realistic view of the complex issues enforcement presented.⁶² Mr. Kiernan advised that the roots of Forbearance had been planted during the Pataki Administration and reflected a determination not to pursue cigarette and petroleum taxes on sales on reservations.⁶³

In 1992 and 1997, efforts to collect the tax caused violent confrontations on the Seneca reservation lands, resulting in serious personal injury, major disruptions and threats to public safety. These actions prompted suspension of tax collection efforts, leading to forbearance.⁶⁴ This forbearance policy has essentially created a huge duty free zone attracting bootleggers buying van loads of cigarettes provided to, and sold by, city stores and street sellers.⁶⁵

On September 23, 2009, Governor Paterson wrote to the United States Attorneys for the Eastern, Northern and Western Districts of New York. This correspondence sought a violence assessment in the event tax collection was initiated and to learn the offices' respective intentions for feared violent resistance to such collection efforts. While there has been no formal response to date, the Governor has been informally advised that the Justice Department will defer all threat assessments to the State Police.⁶⁶

The Paterson Administration has been advised by State Police that tax enforcement now would re-ignite violence, with costs similar to those previously experienced in 1992 and

⁵⁹ See, e.g., *Day Wholesale, Inc.*, 856 N.Y.S.2d at 811 (“In sum . . . the amended version of Tax Law section 471-e cannot become effective absent certain actions, rules and regulations necessary to implement it, and it is undisputed that there have been no such actions taken or rules and regulations promulgated by the Department.”).

⁶⁰ Comiskey Testimony at p. 18.

⁶¹ *Id.* at p. 20.

⁶² Kiernan Testimony at pp. 97-98.

⁶³ *Id.* at pp. 99-100.

⁶⁴ *Id.* at p. 108.

⁶⁵ Testimony of Eric Proshansky (“Proshansky Testimony”) at p. 296.

⁶⁶ Kiernan Testimony at pp. 110-111.

1997.⁶⁷ As evidence for such costs, Mr. Kiernan could only offer the cost “interpolations” provided by the State Police (i.e., reviewing the costs expended in 1992 and 1997 and adjusting them to 2010). Although \$2 million daily enforcement cost has been cited, Mr. Kiernan himself conceded the amount is “not one that should be taken as gospel.”⁶⁸

Active negotiations and litigation have been pursued in an effort to achieve a peaceful resolution of this matter. While the Paterson Administration vigorously enforced bootlegging and smuggling, by assisting federal enforcement actions, it perceives enforcing existing law as a “one dimensional choice” with perceived “deleterious consequences” along the lines of resistance, violence, retrenchment, crime, economic harm, and the poisoning of the relationships that attempt to nurture mutual respect between the State and Native American tribes.⁶⁹

VI. Crime and Bootlegging

The 55 acre Poospatuck Reservation, in Mastic Beach, has 20 smokeshops. The Poospatucks are considered to be notorious sellers of counterfeit Marlboro cigarettes. Altria has brought numerous lawsuits against the Poospatuck smokeshops discovered to be selling counterfeit Marlboros. The sale of counterfeit cigarettes defrauds consumers who seek to purchase actual Marlboro cigarettes, cheats the tobacco manufacturers out of revenue and deprives the State of collecting the cigarette tax thus creating a fraudulent trifecta.⁷⁰

Eric Proshansky, a New York City Assistant Corporation Counsel, was involved in the litigation initiative targeting cigarette tax collection involving Poospatuck Reservation “smokeshop” cigarette sales and Internet sellers. New York City’s enforcement initiatives consisted of lawsuits initiated under the federal RICO statute and the “Federal Contraband Cigarette Trafficking Act” against licensed stamping agents and Native American cigarette sellers.⁷¹

Arrest reports document hundreds of arrests of New York City residents for illegally transporting thousands of cartons of unstamped cigarettes from the Poospatuck Reservation back to New York City.⁷² Many of these individuals have been arrested ten and twelve times.⁷³ New York City’s enforcement efforts were hampered by contentions that the passage of Tax Law § 471(e) implicitly repealed § 471.⁷⁴ As a result, New York State has become the nation’s leading source of untaxed internet cigarette sales, thereby impacting upon New York State and nationally. This policy has cost billions of tax revenue dollars.⁷⁵

67 Id. at p. 108.

68 Id. at pp. 118-120.

69 Id. at p. 100.

70 Id. at p. 74.

71 Proshansky Testimony at p. 293.

72 Id. at p. 299.

73 Id. at p. 300.

74 Id.

75 Proshansky Testimony at p. 301.

Five years of civil litigation has educated New York City to the impact of Forbearance. With State acquiescence, certain cigarette wholesalers deliver unlimited quantities of untaxed cigarettes to Native American smokeshops. Two wholesalers alone delivered 10.3 million cartons of cigarettes to the Poospatuck Reservation. Had these shipments been destined for personal consumption, each Reservation resident would have smoked 900 packs daily.⁷⁶ These deliveries to a single reservation resulted in a 2007 tax loss of \$155 million.⁷⁷ Between September 2008 and 2009, the same two wholesalers sold five million cartons to the Poospatuck Reservation amounting to a State tax loss of \$137 million from the reservation alone.⁷⁸

These types of discrepancies have led Assemblyman Michael Benjamin, who has seen the negative impact the forbearance policy has had on the State and on his hometown neighborhood, to introduce legislation rescinding state recognition of the Poospatuck Indians as an official tribe.⁷⁹

VII. Health

Efforts to curtail smoking, a documented cause of cancer, heart and pulmonary disease, are undermined by cigarette outlets supplying untaxed cigarettes to smoking customers. “Cigarettes kill 25,000 New Yorkers a year, treating cigarette caused disease causes \$8 billion a year in New York, of which more than \$5 billion is paid by Medicaid.”⁸⁰

While much of the investigation focused on fiscal concerns, the issue was not only about taxes, but also involved public health concerns. Studies confirm that higher taxes are one of the most effective ways to reduce smoking among both children and adults. Every ten percent cigarette price increase reduces youth smoking by about seven percent, and overall consumption by four percent. Based on those models, if the tax were collected, 100,000 New Yorkers would quit smoking.⁸¹

76 Written Testimony of Eric Proshansky (the “Proshansky Written Testimony”), October 27, 2009 at p. 2.

77 Proshansky Written Testimony at p. 3.

78 *Id.*

79 A.283.

80 Testimony of Russ Sciandra (“Sciandra Testimony”), October 27, 2010 at pp. 314-315.

81 *Id.* at p. 315.

VIII. Conclusion

The failed policies relating to the collection of cigarette taxes on Native American reservations is due to weak and cowardly decisions. Simply put, there has been a lack of leadership from the Executive Chamber. Forbearance has merely relieved the Governor from the responsibility of exercising the leadership necessary to insure that State laws were faithfully, and equally executed.

Escalating state budget deficits have prompted increases in the State cigarette tax. These increases have driven smokers to less costly sources of supply. A thriving Internet and Native American reservation-based “smokeshops” have successfully attracted those seeking to purchase cheaper cigarettes.

From Mastic Beach to the Canadian border and Niagara Falls, tribal merchants have expanded market share as sequential tax increases has propelled New York to the pyramid of cigarette tax collecting states. New York State has created a perfect storm of desperate demand and a refusal to collect sales tax from tribal retailers and internet merchants.

That legitimate licensed wholesalers and retailers have suffered significant financial losses due to this unfair competition. Sadly, such losses have not prompted positive intervention on their behalf. Governors consistently backed away from action lest Native Americans follow through on threats to riot and vandalize.

The time for new, vital and vigorous executive leadership is needed now, more than ever. A new approach must be taken to craft an honest relationship built on a firm foundation of integrity and fair dealing with New York State’s Native American tribes. For too long, deception and duplicity have been substituted for dignity, honor, and fair play.

The Recommendations enumerated below were carefully crafted and targeted to stop forbearance in its tracks. The twin cancers of appeasement and benign neglect must be eradicated from the State’s governmental playbook.

If New York cannot quickly and effectively recapture a spirit of fair play and provide a level economic playing field, it will have suffered a devastating blow which every regulated licensee will know: New York enforces the law selectively, and only against those it can intimidate and overpower.

As New York considers a further \$1.00 per pack tax increase, the licensed cigarette wholesalers and retailers are literally tottering on the brink of extinction. Four months following the initial Public Hearing, New York has refrained from releasing tax-free coupons for use by Native American purchasers. A set of regulations were released on February 23, 2010 by the Tax Department to repeal Forbearance. These regulations have not been embraced by the industry. Rather, its a “too little...too late” approach to a concededly complex tax-

tion problem. Time has cost the State billions in uncollected tax revenue and millions in lost jobs, failed businesses and reduced license revenues. The emotional toll of failed businesses and unemployment is simply too high to reasonably calculate. The failure to aggressively pursue an available revenue source is, at best, implausible and, at worst, a perceived dereliction of duty resulting in a significant loss of vital state revenue.

New York must lead by example, and not be little more than a tax collecting bully. Native Americans need to recognize that the current system favors a small select group of smokeshop entrepreneurs leaving large numbers of Native Americans beyond the glitzy profits reaped from exploiting Forbearance.

IX. Specific Findings

The sale of cigarettes and petroleum products by Native Americans to non-Native Americans constitutes a lawfully sanctioned taxable transaction.

New York State has failed to live up to prior commitments in dealings with Native American Nations. There has been a lack of respect on the part of the State regarding Native Americans.

The Governor's office, fearful of civil unrest, has adopted a "forbearance" policy refraining from collecting taxes due from these taxable transactions, and unilaterally refusing to distribute "tax exempt" coupons for distribution to Native American purchasers.

Since 1996, the State has failed to collect approximately \$8 billion in cigarette taxes. The State has lost, at minimum, on average \$ 1 billion annually due to the effect of the forbearance policy (since 2003). Through June, 2009 the estimate is in excess of \$675,000,000.

Notwithstanding existing notions of Native American nation sovereignty, the State of New York has expended millions of dollars in governmental and social services directly benefiting Native Americans in such areas as:

- a. highway maintenance
- b. educational services
- c. health care (Medicaid)
- d. higher education
- e. public assistance

The Seneca Nation, the St. Regis Mohawks and the Oneidas, having entered into a compact with the State of New York to build and operate gambling casinos in Western New York under which the New York State Police: (a) conducts employment background searches, and (b) provides casino security and the Seneca Nation has failed to pay \$40 million which the State has billed for these services.

State government has failed to enforce the casino compact to promptly arbitrate disputes, and collect revenues established to be due and owing to the State.

Local retailers of gas stations and convenience store merchants have been driven out of businesses due to the State's forbearance policy.

Local governments have suffered significant declines in tax revenues in areas where Native American smokeshops and gasoline stations operate.

The number of tobacco wholesalers has dramatically declined, with attendant revenue losses, as a consequence of the State's "forbearance" policy.

Notwithstanding the State's "forbearance" policy, Governors' budgets have included unrealistic revenue estimates, mindful that these revenues would not materialize.

X. Recommendations

The State's policy of "forbearance" which Governor Paterson, in his 2010 Budget Address announced, is being rescinded, should be inoperative as soon as possible.

Tax exempt coupons should be distributed by the Department of Taxation and Finance to Native American retailers for use by Native Americans in tax exempt transactions.

Cases involving the possession and sale of national counterfeit brand cigarettes should be vigorously prosecuted both civilly and criminally. Smugglers and those apprehended selling such cigarettes should be prosecuted. Tax Law § 1814(d) should be amended and penalties enhanced to make trafficking in untaxed cigarettes a felony, with trafficking in 1,000 cartons or more a Class D felony, and the fabrication of a tax stamp made a Class D felony. For major traffickers, i.e. those possessing more than 5,000 cartons of unstamped or fraudulently taxed cigarettes, they should face a Class "C" felony.

The State should promptly proceed to resolve the \$40 million unpaid charge for casino security and personal background checks performed on behalf of the Seneca casino operations in western New York State by implementing the arbitration clause contained in each applicable compact.

The activities of "tax stamping agents" should be more closely supervised and regulated, and licenses suspended or revoked when required Jenkins Act filings are not timely and accurately made.

The Legislature should immediately create a "Native American Affairs Committee" in each house of the Legislature to address both short and long term legal and social issues between the State and the Bureau of Indian Affairs (BIA) recognized Native American tribes.

The Governor should appoint a "Deputy Secretary for Native American Affairs" to address all issues affecting these nations, including, but not limited to, arbitration issues involving the collection of cigarette and petroleum taxes, the collection of revenues under the casino compacts and to resolve contested land claims.

The State, which has been involved in negotiations with the Native American tribes seeking to arrive at a “fair and equitable” settlement in connection with unpaid tax arrearages, should enhance the frequency and duration of these discussions.

The State should revoke its recognition of the Poospatuck Tribe.