

## ASSESSMENT OF PUBLIC COMMENT

### DEPARTMENT OF TAXATION AND FINANCE

Written comments were received from the Seneca Nation of Indians (the Nation) and Altria Client Services Inc. on behalf of Philip Morris USA Inc. (PM USA) regarding proposal TAF-35-10-00002-P.

The Nation objects to the imposition of tax with respect to cigarettes sold on its territories, characterizing the imposition of tax as an infringement on its sovereignty and treaty rights. The Nation also asserts that the proposed rule and its regulatory impact statements are not in accordance with the law. The Nation requests that the Department withdraw the proposed rule.

As noted in its submission, the Nation has commenced an action in the United States District Court for the Western District of New York raising sovereignty concerns in challenging the imposition of tax with respect to cigarettes sold on its reservations. Several other actions in state and federal court, involving the Nation and other Indian nations and tribes, are also pending. The Department disagrees with the Nation's assertions and the actions are being defended accordingly. It is noted that, by decision and order dated October 14, 2010, the Court denied the motion by the Nation and the plaintiff-intervener Cayuga Indian Nation of New York for a preliminary injunction, finding that they failed to demonstrate a likelihood of success on their claim that the tax law amendments unconstitutionally burden the right of tribal sovereignty (Seneca Nation of Indians v Paterson, No. 10-CV-687A, WDNY). The Court, however, on the same day, granted a stay of enforcement of the tax law amendments pending appeal. While these proceedings have suspended the Department's ability to enforce the statutory and regulatory amendments, adoption of this rule will maintain the rule, previously adopted and readopted as emergency measure, in place.

The Nation asserts that the rule would impose costs and job impacts that are not recognized in the proposed rule making. The Nation also contends that the Department did not solicit the input of the Nation,

other Indian nations, and reservation businesses concerning these impacts. With regard to this contention, it is noted that the Department's outreach, as stated in the notice of proposed rulemaking, is in compliance with the State Administrative Procedure Act. Furthermore, as noted in the Rural Area Flexibility Analysis, the emergency rule adopted in June was sent to the New York State Indian nations and tribes, including the Nation, at that time. With the exception of the change discussed below, that rule is identical to this rule.

With regard to the Nation's contention concerning the impact, it is the Tax Law itself that imposes the tax and requires Indian nations or tribes to elect to participate in either the coupon or prior approval system. Section 471(1) of the Tax Law imposes the tax on all cigarettes possessed for sale in the State with limited exceptions. As amended by Chapter 134 of the Laws of 2010, section 471(1) explicitly states that the tax is imposed on all cigarettes sold on an Indian reservation to non-members of the Indian nation or tribe and to non-Indians, and provides for a dual system to ensure that adequate quantities of stamped but tax-exempt cigarettes are available for purchase by the nation or tribe and its members for their own use or consumption. Section 471-e, as amended by Chapter 134, establishes the "Indian tax exemption coupon system" which Indian nations or tribes may elect to participate in to obtain these tax-exempt cigarettes, and section 471(5), as added by Chapter 134, provides that for any year that this election is not made, the "prior approval" system will be used. The Tax Law further requires that both coupons and prior approvals be limited by each nation's or tribe's "probable demand," and sets forth the manner by which probable demand will be calculated. Under the Tax Law, all cigarettes sold by agents and wholesalers to Indian nations or tribes or reservation cigarettes sellers located on an Indian reservation must bear a tax stamp. Accordingly, the Tax Law itself imposes the tax and provides that Indian nations or tribes elect to participate in the coupon system or the prior approval system will govern. The rule has a limited function in this regard: it provides guidance and procedures on the legislatively mandated calculation of probable demand, which the Nation does not contest, and the method for agents and wholesale dealers to obtain prior approval for untaxed cigarette sales. Moreover, section 471-e(6) of the Tax

Law, as added by Chapter 134, provides that “[t]he failure of the department to establish, issue and provide Indian tax exemption coupons . . . or to promulgate any rules, regulations or directives necessary to implement the provisions of this section, shall not relieve wholesale dealers of the obligation to sell only tax-stamped cigarettes to Indian nations and tribes, and to reservation cigarette sellers.”

The Nation next expressed concern regarding the mechanics of the prior approval system provided for in the rule. Pursuant to section 471(1) of the Tax Law, if an election to participate in the Indian tax exemption coupon system is not made, the prior approval system will be the mechanism for the delivery of tax-exempt cigarettes to Indian nations or tribes and their members for their use or consumption. The rule establishes that agents and wholesale dealers may sell certain quantities of stamped untaxed packages of cigarettes to Indian nations or tribes and reservation cigarette sellers with the prior approval of the Department through the use of an interactive Web application. The Nation states that the rule includes no safeguards to prevent state-licensed wholesalers or reservation retailers from hoarding the quota of untaxed cigarettes and exacting inflated prices or diverting tax-exempt cigarettes to other markets for sale to non-nation members. The Nation asserts that the rule would permit state-licensed wholesalers to sell directly to reservation retailers and to circumvent the market-role of Nation-licensed stamping agents and wholesalers in the distribution of cigarettes on the reservations. According to the Nation, the prior approval system does not protect the ability of Nation-licensed retailers, wholesalers, and stamping agents to participate in undisputed tax-free commerce.

It is noted that neither the law nor the rule seeks to comprehensively regulate the on-reservation distribution of the cigarettes. The law and rule do not compel state-licensed agents and wholesalers to sell to reservation retailers rather than Nation-licensed agents and wholesalers in circumvention of the Nation’s distribution system. With regard to the hoarding issue, the system set up by the Department requires wholesalers who have received prior approval for the sale of tax-exempt cigarettes to verify the sale within 48 hours or the approval expires. A person diverting tax-exempt cigarettes off the reservation to other markets would be doing

so in violation of law and subject to criminal and civil sanctions and, in the case of a state-licensed wholesaler, license revocation (see, Tax Law, sections 472, 480[3]). The law and rule ensure that adequate quantities of stamped but tax-exempt cigarettes are available for purchase by the nations or tribes and their members for their use or consumption.

The statute does provide a mechanism for the nations and tribes to affect the on-reservation distribution of the tax-exempt cigarettes: the coupon system. In this regard, revisions were made to the proposed rule in light of the uncertainty created by the federal and state court challenges that have precluded implementation of the statutory and regulatory amendments on September 1, 2010. These revisions, in section 74.6(b)(1) of the rule, provide flexibility both now and in the future by authorizing the Department to allow the election to participate in the coupon system to be made on a date other than the preceding August 15 for the twelve-month period beginning September 1 and ending August 31.

PM USA's comments advocate for the implementation and enforcement of the tax laws and regulations concerning sales of cigarettes on Indian reservations. PM USA expressed concern that the proposed rule, through its focus on the requirements of state-licensed stamping agents with regard to the coupon and prior approval systems and the certification procedures, may be viewed as allowing other persons to sell unstamped cigarettes to retailers, including tribal cigarettes sellers, for resale in New York. Initially, it is noted that the Department is aware that enforcement issues are raised by untaxed cigarettes being introduced into New York through other, illegal channels. However, the proposed rule does not override and is not in conflict with existing cigarette tax laws and regulations which provide that unstamped cigarettes may generally only be introduced into the New York State market through licensed cigarette stamping agents.

With regard to the agent certification provisions of the proposed rule, PM USA asserts that manufacturers like itself will be unable to determine whether an agent's certification is made in good faith and whether an agent's sales of unstamped cigarettes are in compliance with Article 20 of the Tax Law, and

suggests that the Department provide notice to suppliers as to whether particular agents are violating the law. The Department believes that the statutory obligation of the manufacturer as set forth in the rule is clear—to not sell unstamped packages of cigarettes to an agent unless it has received the required certification (Tax Law section 471[4][A])—and no revisions are necessary in this regard.

Lastly, PM USA offered two clarifying changes to the proposed rule in sections 74.7(b)(2) and (3) regarding the contents of the agent certification. Again, the Department believes the agents' obligations are clear in these provisions and did not make the suggested revisions.

Other than the change to authorize the Department to allow the election to participate in the coupon system at a later time discussed above, no changes have been made to the rule.