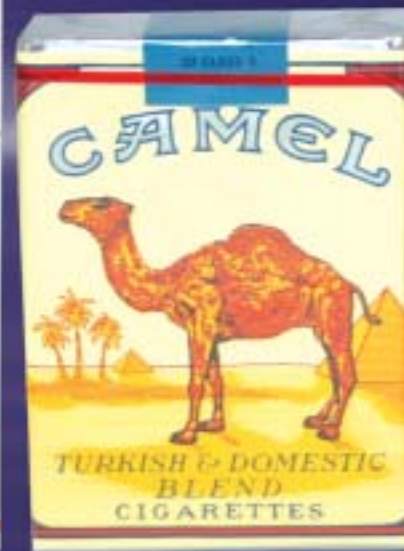


AN AWMA RESEARCH STUDY

Internet Cigarette Sales: *Federal Action is Needed Now*



www.cheap-cigarette-site.com

www.cigoutlet.com

es-sale.com

www.smokers.com

www.000cigarettes.com



AMERICAN WHOLESALERS MARKETERS ASSOCIATION

EXECUTIVE SUMMARY

- Despite a recent agreement between major credit card companies, states attorneys general, and the Bureau of Alcohol, Tobacco and Firearms to halt the use of credit cards for Internet cigarette sales, a researcher with AWMA easily used a credit card to purchase 14 cartons of cigarettes—eight cartons were within the United States and six were from foreign countries.
- Of the 30 random sites used to purchase cigarettes, 53% allowed the use of a credit card—Visa, Diners, Mastercard, and/or American Express.
- None of the cigarettes purchased had any U.S. state tax stamps and in no case were taxes collected at the time of purchase.
- The American Wholesale Marketers Association notified the Virginia Department of Taxation of the tax stamp omission and paid the appropriate amount of tax to comply with the law. While the tax was eventually paid, it was clear that the state did not have a system in place to collect state taxes on cigarettes purchased over the Internet.
- Age verification was virtually nonexistent. Most sites simply had a statement on the home page saying that a purchaser had to be of a certain age to buy cigarettes but nothing beyond to prevent an underage person from buying the cigarettes. Some asked for a simple check off that the buyer was over 18.
- This study clearly demonstrates that efforts to restrict illegal cigarette sales via the Internet are falling short of the mark. Federal legislation that addresses this problem is clearly required.



INTRODUCTION

At a recent meeting of the American Wholesale Marketers Association's government affairs committee, members cited Internet sales of tobacco as the most pressing problem facing our industry. In response, AWMA set out to conduct a study to determine just how widespread this problem is and whether state and local efforts to combat these illegal sales are working. What we found is truly astounding and very troubling.

This report provides background on the issue and documents, in detail, AWMA's foray into the murky world of Internet tobacco sales, which took place between June 20 and 29, 2005. Clearly, despite the best efforts of many lawmakers, enforcement agents, tobacco companies, and others, the illegal sale of these products continues to flourish. Every sale of an illegal tobacco product over the Internet translates into a loss for responsible, legitimate, law-abiding distributors and retailers across the country.

And it's not just our industry that's impacted—states are losing millions of dollars each year in unpaid excise taxes and enforcement expenses. And, more importantly, many of the cigarettes sold over the Internet are ending up in the hands of under-age smokers because of the lack of safeguards inherent in these types of remote sales.

While AWMA supports the efforts made by those working to end illegal Internet sales of cigarettes, the findings in this report point to the critical need for federal action to win the war against these illegal sales. There is much at stake and it has become increasingly clear that this problem cannot be effectively addressed at the state or local level, or by voluntary agreements alone. For this reason, AWMA will continue to work

to promote enactment of legislation on the federal level aimed at strengthening the Jenkins Act and ending these illegal sales.



BACKGROUND

The Jenkins Act law, passed by Congress in 1949, requires all retailers of cigarettes in interstate commerce to report to state tobacco tax administrators the name, address, brands and quantities shipped. The reporting requirements outlined under the Jenkins Act were designed to ensure that state authorities would have the ability to recover excise taxes from those consumers who might have been looking to avoid paying state taxes by buying cigarettes from no-tax or low-tax states.

Obviously, when the 1949 Jenkins Act was enacted there was no “Internet”—which has become one of the fastest growing areas of remote sales of cigarettes. For this reason, lawmakers on both the State and Federal level have been working to address this “new” avenue of remote sales and to put more teeth into the over 50-year-old Jenkins Act to ensure that states receive the excise taxes they are due and to promote more reliable age verification.

Additionally, state and federal government officials recently reached an agreement with the major credit card companies in the U.S. to no longer allow their cards to be used to purchase cigarettes over the Internet. Virtually all credit card companies—including Visa, MasterCard,

Discover and American Express—signed off on an agreement with officials of 10 states and the federal Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) to prevent the illegal cigarette sales over the Internet. The ATF estimates that millions of dollars from illegal cigarette sales are diverted each year to terrorists and criminal organizations. This agreement comes on the heels of new efforts by many states to collect cigarette excise taxes directly from consumers who have purchased the products on the Internet. Recently, some consumers have been presented with bills for thousands of dollars worth of back excise taxes.

And, lawmakers are also targeting those that deliver these products as well. Congressman John McHugh (R-NY) recently introduced legislation that would prohibit the delivery of cigarettes and other smokeless tobacco products by the U.S. Postal Service (USPS). A few states, including New York, have banned the shipment of tobacco products by private carriers but these laws do not affect the U.S. Postal Service which is a federal entity. AWMA has written to Rep. McHugh expressing support for his bill which we believe will help tighten the screws on these illegal Internet sales of tobacco products.

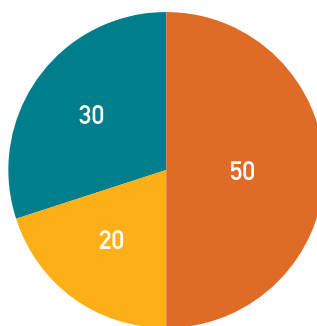


SCOPE AND METHODOLOGY

To determine whether or not Internet cigarette vendors were in compliance with the laws set forth in the Jenkins Act—and if the effort to prohibit the use of credit cards was working—we began by randomly selecting Web site addresses using the Internet search engine, Google™. To conduct the search for Internet cigarette vendor sites, the key words used were “cigarette sales,” “cigarettes online,” and “cheap cigarettes.” Thirty Internet cigarette vendors were selected for the study. The pages within each Web site were reviewed for such information as Web site location, origin of cigarettes, cigarette brands, cost per carton, age verification to purchase, delivery time, arrival date, age verification upon delivery, tax stamps and their location on the packs, credit card acceptance, and company processing credit card on statement.

SITE LOCATION

Of these 30 Internet cigarette vendor sites, six (20%) are located in Europe or Canada, fifteen (50%) are located in U.S. or Native American lands, and the remaining nine sites (30%) are either unknown or in the U.S. but exact location could not be determined. Some of the Web sites appeared separate but had the same mailing address and telephone numbers suggesting that they might be operated by one company. This mainly applied to the Native American sites.



WEB SITE LOCATIONS

- U.S. or Native American Lands
- Europe or Canada
- Unknown Origin



WEB SITE RESEARCH

SITE NAME	SITE LOCATION	ORIGIN OF CIGARETTES	CIGARETTE BRANDS	COST PER CARTON	AGE VERIFICATION	SHIPPING/ DELIVERY TIME
www.discount-cigarettes-store.com	Unknown	USA, Europe	European and American premium brands; Marlboro purchased 6/21/05 on Mastercard	\$14.50	Check box; DL # required	2–3 weeks
www.cigoutlet.net	Ottawa, ON	Ukraine	American premium brands; purchased Marlboro Lights 6/20/05 on AmEx	\$12.40	Check box	10–15 days
www.cigarettesamerica.com	Unknown; site says shipped from Native American lands	USA	American premium brands	None purchased	Requires DOB/ DL information	UPS and USPS options
www.esmokes.com	Unknown	Unknown	American, foreign, specialty	None purchased	Check box to verify 21	UPS and USPS options
www.senecasmokes.com	Lewiston, NY	USA	American brands, natural Native	None purchased	By placing order you certify that you are at least 18	N/A
www.cigaretteexpress.com	Jemez Pueblo, NM	USA	Value, generic, premium, specialty	None purchased	Site indicates you must be 18 or order will not be processed	Only via priority mail
www.cheap-cigarettes-sale.com	Europe	Russia	European and American premium brands; Virginia Slims purchased 6/20/05 on AmEx	\$15.95	Yes, check box	International airmail/ 2–3 weeks
www.bestsmokers.com	Italian Swiss Co.	Europe, Switzerland, Philippines	Premium brands containing American blend tobacco; tried to purchase Winston Lights but error occurred during transaction	3 carton minimum @ \$9 each	No	Airmail priority
www.000cigarettes.com	United Kingdom	Russia	Premium and value brands; European and American; purchased Chesterfield Classic on 6/20/05 with Mastercard	\$17.95	Statement saying you must be 21 to order online	2–3 weeks USPS
www.sendcigarettes.com	Unknown	Unknown	American, British American, Native; purchased Marlboro Lights 6/20/05	\$34.95	Requested DOB as required field	USPS priority 2–3 days
www.tobaccobymail.com	Allegany Indian Reservation	USA	American and Native brands	None purchased	Statement saying you must be at least 18 to order online	USPS with required signature
www.smokeday.com	Prague	Ukraine	American and European brands; purchased Marlboro Lights 6/20/05 on Mastercard	\$18.94; minimum 3 cartons	Statement saying you must be 18 to buy tobacco products	Airmail to USA
www.smokers.com	Salamanca, NY	USA	American premium brands; purchased Camel regulars 6/23/05	\$32.90	Homepage has statement saying when you enter the site you are confirming you are 21 or older	8–12 business days via USPS
www.eztobacco.com	New Mexico	USA	American brands; no purchase made	N/A		N/A
www.dynamictruth.com	USA	USA	American brands; no purchase made	N/A	No statement or question regarding age	USPS
www.rednationtobacco.com	Salamanca, NY	USA	American brands; no purchase made	N/A	Statement on home page saying you must be 18 to order cigarettes	N/A

ARRIVAL DATE	DELIVERY AGE VERIFICATION	TAX STAMP? WHERE?	CREDIT CARD ACCEPTED?	CREDIT CARD PROCESSED THRU?	OTHER COMMENTS
6/29/2005; return address from Salamanca, NY	No, sent UPS	None	Yes, Mastercard	First Processing Corp. 813-962-1115	Site states that it sells discount cigarettes made in USA shipped from Seneca Nation of Indians in Salamanca, NY and discount cigarettes made in and shipped from Europe.
7/5/2005; return address Moldova	No; sent USPS	Only Moldova stamp on pack side	Yes, Visa, AmEx, Diners	Jumbomall.com	Mastercard no longer participates.
N/A	N/A	N/A	No, only electronic checks	N/A	
N/A	N/A	N/A	Site indicates they accept Visa, Mastercard, AmEx but payment page only accepted electronic checks	N/A	When we tried to buy, a message came up saying they were no longer accepting orders from our state.
N/A	N/A	N/A	No, only electronic checks	N/A	
N/A	N/A	N/A	No, only electronic checks	N/A	
7/8/05	No	Only Russian stamp on side of each pack	Yes, Visa, AmEx, Diners	Jumbomall.com	
N/A	N/A	N/A	No; site indicates Visa and Mastercard accepted but would not process transaction	N/A	When all credit card information was entered, an error message came up saying it could not process order. Another attempt was made several days later with same response.
7/5/05	No	Only Russian stamp on side of each pack	Yes, Visa, Mastercard	Chronopay.com (Netherlands)	
6/27/05	No, sent priority mail USPS	No stamp	Yes, Visa, AmEx, Mastercard	May appear on your credit card as Cigarettes 0850 or Smoke Online or Movie Online	Native discount tobacco store.
N/A	N/A	N/A	No	N/A	
7/18/05	No	Only Ukraine stamp	Yes, Visa, Mastercard	Not indicated on Web site	
6/29/05	No, sent priority mail USPS	No stamp	Yes, Mastercard	Nationwide Marketing Company, Kilgore, TX	Site managed by T.O. for Seneca Indian Territories.
N/A	N/A	N/A	No	N/A	
N/A	N/A	N/A	Yes, Visa	N/A	
N/A	N/A	N/A	No	N/A	

Information accurate as of June 2005.

WEB SITE RESEARCH (cont.)

SITE NAME	SITE LOCATION	ORIGIN OF CIGARETTES	CIGARETTE BRANDS	COST PER CARTON	AGE VERIFICATION	SHIPPING/ DELIVERY TIME
www.ordersmokesdirect.com	Unknown	USA	American brands; no purchase made	N/A	Before you can enter site, pop up screen states you must be 21 to purchase tobacco products online; by clicking OK you agree that you are at least 21	N/A
www.cheapsmokesbymail.com	Allegany Indian Reservation, Salamanca, NY	USA	American premium and generic brands; no purchase made	N/A	Home page has statement saying when you enter site you are confirming you are 21 or older	N/A
www.acigs.com	Pueblo of Jemez, Santa Fe, NM	USA	American brands; no purchase made	N/A	None	N/A
www.cigarettes.cheap-buy.com	Unknown	USA	American brands; no purchase made	N/A	Statement saying you must be 18 to buy tobacco products	N/A
www.travelingsmoke.com	Seneca Nation Territory, Irving, NY	USA	American premium, generic, value brands; ordered 4 cartons Pall Mall 6/23/05	\$30.50; 4 carton minimum	Statement saying you must be 18 or older to order; pop-up box to click "I agree"	N/A
www.cigarettesentdirect.com	Seneca Nation Territory, Irving, NY	USA	American premium, native, generic brands; ordered Doral FF King Box 6/23/05	\$28.80; 4 carton minimum	Statement saying you must be 18 or older to enter site	Ships priority mail USPS
www.bigdaddysmokes.com	Kentucky	USA	American premium, generic, value brands; no purchase made	N/A	Site states a photo ID must be faxed at time of purchase	N/A
www.eaglecigs.com	N. Myrtle Beach, South Carolina	USA	Premium and value brands; purchased Newport 6/28/05; cancelled order	\$37	Site has ID Response (Virtual Age Authentication) with statement saying you must be 21 to purchase tobacco products from site; all first time purchasers are age verified	N/A
www.cheap-cigarette-site.com	Unknown	Europe, Russia, USA	Foreign and domestic brands; purchased Marlboro Ultra Lights 6/29/05 on Mastercard	\$22.95	No mention of age on site	14–24 days
www.cartonsofsmokes.com	Unknown	Unknown	American brands; no purchase made	N/A	Statement saying you must be 21 to order	N/A
www.stardatesmokes.com	Unknown; Native American	USA	Premium and generic brands; no purchase made	N/A	Statement on home page saying you must be 18 to order cigarettes	N/a
www.salamancacigaretteoutlet.com	New York	USA	Premium, generic, economy brands; tried to purchase Marlboro Lights but unable to complete transaction online	\$26	Statement on home page saying you must be 18 to order cigarettes; had to enter birthdate on checkout page	N/A
www.cigarette-cigarettes.com	Unknown; site says shipped from Native American lands	USA	Premium and generic brands; no purchase made	N/A	Statement on home page saying you must be 18 to order	N/A
www.cigdis.com	Europe	Europe	American and European brands; ordered Marlboro Lights 6/29/05 via Pay Pal	\$23.95	None stated	14–29 days

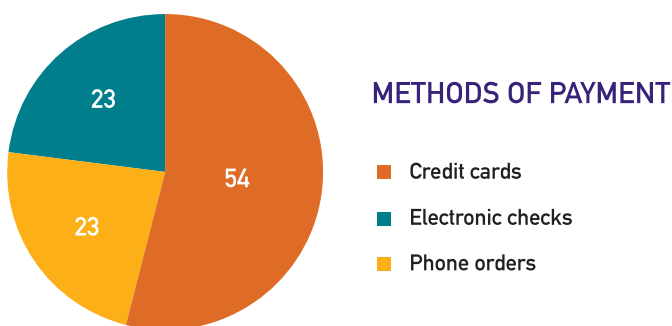
ARRIVAL DATE	DELIVERY AGE VERIFICATION	TAX STAMP? WHERE?	CREDIT CARD ACCEPTED?	CREDIT CARD PROCESSED THRU?	OTHER COMMENTS
N/A	N/A	N/A	No	N/A	
N/A	N/A	N/A	No; must mail in check or money order	N/A	
N/A	N/A	N/A	No, only electronic checks	N/A	
N/A	N/A	N/A	Home page states Visa, Mastercard, AmEx accepted, but payment page only allows VISA	N/A	
7/5/05	No	No stamp	Yes, Mastercard	Not indicated on Web site	Required a 4 carton minimum purchase.
6/30/05	No	No stamp	Yes, Mastercard and Visa	Not indicated on Web site	Required a 4 carton minimum purchase.
N/A	N/A	N/A	No, only electronic checks although home page states they take credit cards	N/A	
N/A	N/A	N/A	Yes, Visa, Mastercard, AmEx	N/A (cancelled order)	Order cancelled because they would not ship to business address and wanted a home address, as part of age verification.
7/15/05	No	Only Ukraine stamp	Yes, Visa, Mastercard, AmEx		
N/A	N/A	N/A	No, only electronic checks	N/A	
N/A	N/A	N/A	Yes, only Visa	N/A	Could not place order because didn't have a Visa credit card.
N/A	N/A	N/A	No; must phone in order using Visa or Mastercard	N/A	After completing payment page, credit card was not accepted over Web site and was prompted to call in the credit card information.
N/A	N/A	N/A	Yes, only Visa	N/A	Could not place order because didn't have a Visa credit card.
			Yes, Mastercard through Pay Pal	Pay Pal	

Information accurate as of June 2005.

SUMMARY

METHODS OF PAYMENT

Even though this was a small sample study, it clearly demonstrates how easily cigarettes can be bought via the Internet with a credit card. From the 30 Internet cigarette vendors, cigarettes were purchased from 11 (37%) of them. All purchases were made with either Mastercard or American Express. A total of 16 Web sites accepted credit card transactions online using Visa, Mastercard, Diners, and/or American Express. Seven of the Web sites accepted only electronic checks. Seven sites either stated they no longer allowed sales through their Internet site, an error message was displayed when a credit card purchase was attempted, or instructions were given to place an order by phone using a credit card.



ORIGIN, BRANDS AND PRICING OF CIGARETTES

In some cases, it was difficult to tell exactly where the cigarettes originated. The European and Canadian sites sell premium American brands made in Russia and the Ukraine as well as foreign brands. The U.S. sites sell American premium, value, and generic brands along with some Native brands.

Prices per carton ranged from \$12.40 for the premium American brands made in Russia to \$37 per carton for premium American brands made in the U.S. Four of the Web sites had a minimum order requirement of three or four cartons.

DETERMINING WHETHER THE CIGARETTES WERE COUNTERFEIT

Counterfeit cigarettes have become a growing problem in the U.S., with the Philip Morris Marlboro brand the most highly counterfeited. Because it is known that the Internet is one channel for distribution of counterfeit product, AWMA asked Philip Morris experts to review the Philip Morris products purchased to determine whether any of the product was counterfeit. The Philip Morris analysis concluded:

“Philip Morris USA has inspected the cigarettes and determined that they are genuine Philip Morris manufactured cigarettes. One of the cartons, Marlboro Lights King Size Soft Pack, is PM USA product intended for sale in the United States. The other cartons are genuine Philip Morris International branded cigarettes intended for sale outside of the United States. Sales of such cigarettes in the United States are illegal.”

AGE VERIFICATION

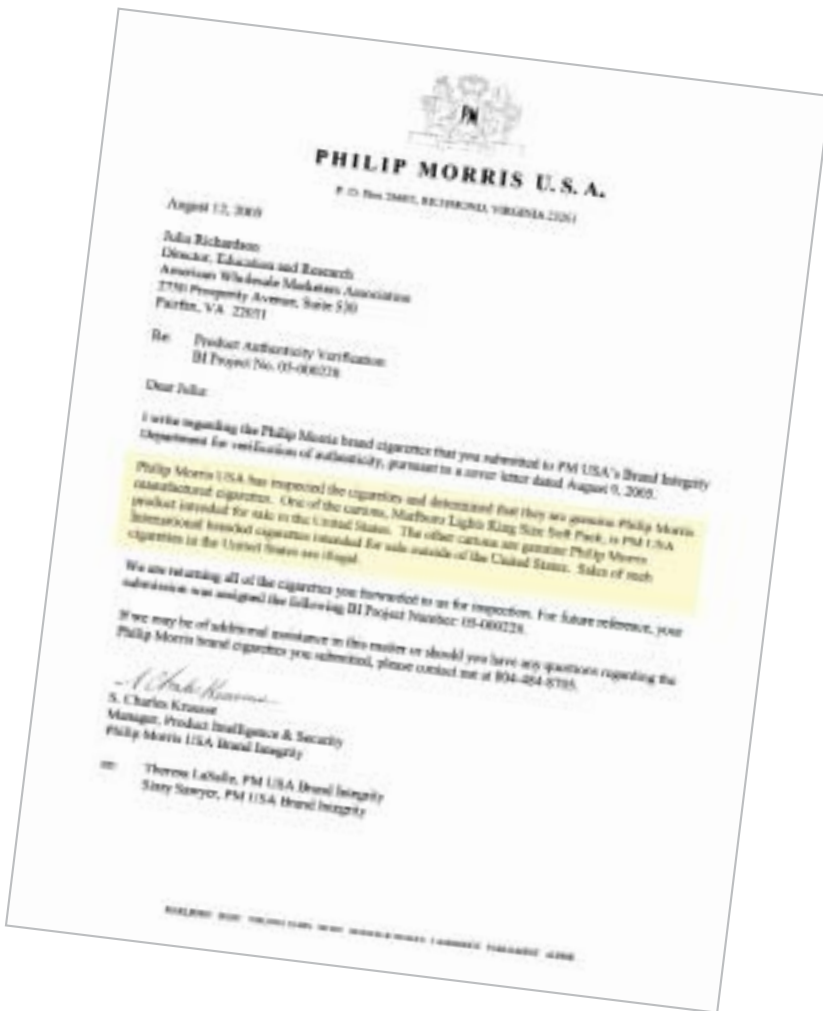
As part of the buying process, close attention was paid to the age verification process to determine if cigarettes could be purchased by under-age smokers. Eighteen of the sites had a statement on their home page or somewhere within the site stating that you must be 18 years of age (some 21 years of age) to purchase cigarettes from the site. One of these 18 sites also required that identification be shown upon delivery, which could only be made to a home address. Three sites asked for a driver's license number or date of birth on the checkout form. Four sites had a required field with a check box to certify that you were of legal age. Five sites made no mention of age requirements. In the case where cigarettes were purchased from sites requesting a driver's license number or date of birth, false information was entered.

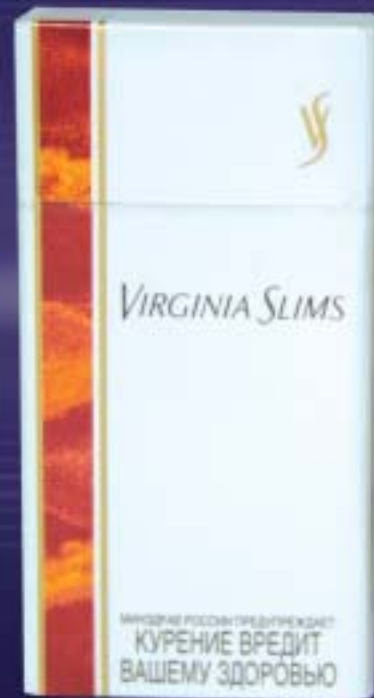
Upon delivery of the purchased cigarettes, no attempt was made to verify the age of the recipient. The only signature requested was for delivery notification. Therefore, it can be concluded that an underage person can find and purchase cigarettes online with no difficulty.

CONCLUSION

Although AWMA undertook this study recognizing that the problem of Internet trafficking of cigarettes is a growing concern, we were ultimately shocked by what our study revealed in terms of the scope of the problem and the lack of adequate enforcement. Estimates show that there are over one billion Internet users worldwide and this growth in Internet use has fueled a corresponding increase in the e-commerce industry. Unfortunately, illegal Internet tobacco sales have also mirrored this rise in e-commerce. Some estimates point to a loss of almost \$14 billion in state revenue as a result of these remote sales. And, the ability of underage smokers to secure these products intended for adults is of tremendous concern as well.

While many states are working to address this issue through various legislative and enforcement avenues, it is clear that these patchwork efforts are falling short and a more comprehensive solution is needed to effectively combat illegal Internet cigarette sales nationwide. Enactment of federal legislation strengthening the Jenkins Act is critical to ensure that states receive the excise taxes they are due and to promote more reliable age verification. Passage of such legislation will also go a long way toward promoting a more fair and level playing field with respect to competition between the traditional retailers of tobacco products and the remote sellers. AWMA remains committed to securing passage of federal legislation to improve the Jenkins Act and end the illegal remote sales of tobacco products.





www.travelingsmoke.com

www.sendcigarettes.com

www.discount-cigarettes-store.com

www.cheap-cigarette.com



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