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## NYC sues roll-your-own cigarette shops over taxes

Mayor Michael Bloomberg announced a lawsuit against two "roll-your-own" cigarette shops in Chinatown, which sell cigarettes for well below the city's average price, thanks to a tax loophole.

Associated Press

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Mayor Michael Bloomberg, who has advocated for aggressive legal action against cigarette sellers who avoid taxes, announced a lawsuit against two "roll-your-own" cigarette shops in Chinatown at a news conference Monday.

Thanks to a loophole that officials in several states are now trying to close, patrons who visit Island Smokes or Island Smokes III can walk out with an entire 10-pack carton for less than \$40. A growing number of similar stores around the country have come under fire over their use of high-speed cigarette rolling machines that function as miniature factories, and can package loose tobacco and rolling papers into neatly formed cigarettes, sometimes in just a few minutes.

The secret to Island Smokes' low prices is simple: Even though patrons leave carrying cartons that look very much like the Marlboros or Newports, the store charges taxes at the rate set for loose tobacco, which is just a fraction of what is charged for a commercially made pack.

"They are trying to get around the law by claiming they're not in the business of selling cigarettes, when they clearly are," said Mr. Bloomberg in a statement. "Most businesses abide by the law, play by the rules and pay their taxes. We are not going to allow some businesses to skirt the law and we will ensure the playing field is level."

The savings come at every level. Many stores sell customers loose pipe tobacco, which is taxed by the federal government at \$2.80 per pound, compared with \$25 per pound for tobacco made for cigarettes. The shops don't pay into the cigarette manufacturer trust fund, intended to reimburse government health programs for the cost of treating smoking-related illness. And the packs produced by "roll-your-own" shops are generally also being sold without local tax stamps, which in New York include a \$1.50 city tax and a \$4.35 state tax.

New York City's legal department filed a lawsuit against Island Smokes on Nov. 14, arguing that the company's Manhattan store and another on Staten Island are engaging in blatant tax evasion.

Every package of cigarettes sold in the state, the suit argued, must bear a New York tax stamp. Businesses that sell unstamped cigarettes are violating both local law and the federal Contraband Cigarette Trafficking Act, city lawyers said. The suit, filed in federal court in Manhattan, also accused the store of violating a state law requiring cigarettes to meet fire safety standards.

"By selling illegally low-priced cigarettes, defendants not only interfere with the collection of city cigarette taxes, they also impair the city's smoking cessation programs and impair individual efforts at smoking reduction, thereby imposing higher health care costs on the city and injuring public health," the complaint said.

A pack contains 20 cigarettes and sells for around \$13 in New York City after taxes are added. That compares with the national average in 2010 of \$4.80 a pack, according to the Centers for Disease Control and Prevention. A pack from Island Smokes can cost less than \$4 a pack.

Everything about the business is legal, precisely because the company is neither selling cigarettes, nor manufacturing them, said Jonathan Behrins, a lawyer for Island Smokes. It is simply selling loose tobacco and tubes, he said, and giving customers access to the rolling machines to make the cigarettes themselves.

"What's the harm?" he said. "They are not selling unstamped cigarettes."

Mr. Behrins said the business, whose owners include a New York City police captain, opened in April. It has developed a clientele of people who are trying to save money, and don't mind spending some time at the machines, rolling their own product.

"It's a certain demographic that rolls their own. They don't really want to be bothered with Bloomberg reaching into their pockets."

He likened the operation to a brew-your-own-beer store, and chafed at the idea that it might cost the city substantial tax revenue. Some smoke shops use roll-your-own machines that can churn out a carton of 200 cigarettes in eight minutes, but Mr. Behrins said Island Smokes' machines are far slower. City investigators said it took them about 45 minutes to make one carton.

"This is why I don't understand why the city has us in their sights," said Mr. Behrins.

Legal battles over shops using roll-your-own machines are ongoing in several states.

Wisconsin's Department of Revenue this year informed machine owners that they need manufacturing and distribution permits to operate. Enforcement of the order has been put on hold while a judge considers the matter.

In West Virginia, a judge ruled in September that a tobacco shop there was violating state and federal law by failing to charge excise taxes on cigarettes made by customers with automated, on-site rolling machines.

New Hampshire's Supreme Court ruled in July that a roll-your-own tobacco shop there was effectively a cigarette manufacturer, and thereby had to pay into the national fund that reimburses Medicare for smoking-related illnesses. The New Hampshire attorney general said those payments amount to about \$5.33 per carton. The Massachusetts attorney general has also classified retailers who use roll-your-own machines as manufacturers.

That argument has also been adopted by the U.S. Treasury Department's Alcohol and Tobacco Tax and Trade Bureau, which issued a ruling Sept. 30 that retailers who give customers access to roll-your-own cigarette machines are manufacturers, and are subject to the same licensing rules as other cigarette makers. Those regulations, among other things, would require the shops to apply for a permit before going into business, post a bond, and keep certain inventory records.

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