

UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF NEW YORK

AMON, J.

THE CITY OF NEW YORK,

**MATSUMOTO, M.J.** COMPLAINT

Civil Action No.

-against-

MILHELM ATTEA & BROS., INC., DAY  
WHOLESALE, INC., GUTLOVE & SHIRVINT, INC.,  
MAURO PENNISI, INC., JACOB KERN & SONS, INC.,  
WINDWARD TOBACCO, INC. and CAPITAL CANDY  
COMPANY, INC.

Defendants.

FILED  
IN CLERK'S OFFICE  
U.S. DISTRICT COURT E.D.N.Y.  
\* JUL 24 2006 \*  
BROOKLYN OFFICE

Plaintiff the City of New York (the "City"), by its counsel Michael A. Cardozo, Corporation Counsel of the City of New York, respectfully alleges, with knowledge of its own actions and on information and belief as to the actions of others, as follows:

**Nature of the Action**

1. This is a civil action under the Contraband Cigarette Trafficking Act (18 U.S.C. § 2341 *et seq.*), the Cigarette Marketing Standards Act (N.Y. Tax L. § 483 *et seq.*) and common law to enjoin the defendants' illegal sale, transport and distribution of contraband cigarettes and to recover damages for taxes lost as a result of defendants' activities.

2. Each defendant is a wholesale cigarette dealer licensed by the State of New York to sell cigarettes and to apply New York State cigarette tax stamps pursuant to N.Y. Tax L. §§ 472(1) and 480(1)(a). In violation of applicable law, each defendant sells cigarettes at wholesale (a) without paying the taxes required by law on each carton of cigarettes and (b) without affixing a State tax stamp to each package of cigarettes. Each defendant therefore sells

“unstamped packages of cigarettes” within the meaning of N.Y. Tax L. § 470(13), referred to herein as “unstamped cigarettes.”

3. Because as much as half of the retail price of cigarettes sold in New York City is attributable to taxes, defendants’ failure to pay taxes and affix tax stamps in turn allows retail cigarette sellers supplied by defendants to make a profit by selling cigarettes at prices well below the prices of retailers selling cigarettes on which taxes have been paid.

4. The substantially lower price of the unstamped cigarettes that defendants supply to cigarette retailers induces large numbers of City residents to purchase the unstamped cigarettes, which are widely available at retail stores in and outside of the City, on the street, over the Internet, or by mail, fax and telephone.

5. The vast majority of sales of unstamped cigarettes replace sales that would otherwise generate tax revenues for the State, and, in significant part, for the City. Sales of unstamped cigarettes annually cost New York City millions of dollars in tax revenues.

6. Sellers of unstamped cigarettes are also major suppliers of cigarettes to underage smokers. Such sellers rarely, if ever, comply with N.Y. Public Health L. §§ 1399-cc(3) or 1399-ll, which require proof-of age and prohibit non-face to face (“remote”) cigarette sales. Defendants thereby cause, create and contribute to a public nuisance.

7. In this action, the City of New York seeks to: i) enjoin defendants from selling unstamped cigarettes; ii) recover from defendants the amount of City tax revenues lost as a result of defendants’ unlawful activities and iii) recover the attorney’s fees and costs incurred in bringing this action.

## PARTIES

8. Plaintiff the City of New York (the "City") is a municipal corporation organized under the laws of the State of New York (the "State").

9. Milhem Attea & Bros., Inc. ("Attea") is a domestic corporation organized and existing under the laws of the State. Attea is a licensed cigarette stamping agent and wholesale cigarette dealer that sells cigarettes and other tobacco products. Attea's principal place of business is located at 1506 Clinton Street, Buffalo, New York.

10. Day Wholesale, Inc. ("Day") is a domestic corporation organized and existing under the laws of the State. Day is a licensed cigarette stamping agent and wholesale cigarette dealer that sells cigarettes and other tobacco products. Day's principal place of business is located at 151 Park Street, Tupper Lake, New York.

11. Gutlove & Shirvint, Inc. ("Gutlove") is a domestic corporation organized and existing under the laws of the State. Gutlove is a licensed cigarette stamping agent and wholesale cigarette dealer that sells cigarettes and other tobacco products. Gutlove's principal place of business is located at 39-26 23<sup>rd</sup> Street, Long Island City, New York.

12. Mauro Pennisi, Inc. ("Pennisi") is a domestic corporation organized and existing under the laws of the State. Pennisi is a licensed cigarette stamping agent and wholesale cigarette dealer that sells cigarettes and other tobacco products. Pennisi's principal place of business is located at 78-80 West Hoffman Ave., Lindenhurst, New York.

13. Jacob Kern & Sons, Inc. ("Kern") is a domestic corporation organized and existing under the laws of the State. Kern is a licensed cigarette stamping agent and wholesale cigarette dealer that sells cigarettes and other tobacco products. Kern's principal place of business is located at 56-60 Nicholls Street, Lockport, New York.

14. Windward Tobacco, Inc. ("Windward") is a domestic corporation organized and existing under the laws of the State. Windward is a licensed cigarette stamping agent and wholesale cigarette dealer that sells cigarettes and other tobacco products. Windward's principal place of business is located at 34 Sunburst Circle, East Amherst, New York.

15. Capital Candy Company, Inc. ("Capital") is a foreign business corporation organized and existing under the laws of the State of Vermont and authorized to do business in this State. Capital is a licensed cigarette stamping agent and wholesale cigarette dealer that sells cigarettes and other tobacco products. Capital's principal place of business is located at 32 Burnham Street, Barre, Vermont.

#### **JURISDICTION AND VENUE**

16. The court has jurisdiction over the subject matter of this action pursuant to 18 U.S.C. § 2341, 28 U.S.C. § 1331 and 28 U.S.C. § 1367(a).

17. Venue is proper under 28 U.S.C. § 1391(b) because a substantial part of the events and omissions giving rise to the claims occurred in this district.

#### **FACTS**

##### **Cigarette Taxation and Regulation in New York**

18. The State and City of New York each impose an excise tax on all cigarettes possessed for sale or use in their respective jurisdictions. *See* (1) New York State Tax Law ("N.Y. Tax L.") §§ 471 and 471-a and (2) Administrative Code of the City of New York ("Admin. Code") § 11-1302(a)(1). The New York State excise tax on cigarettes is presently \$1.50 per pack. The New York City excise tax is \$1.50 per pack. The combined State and City

sales tax is \$0.33 per pack. The total tax on a pack of cigarettes sold in New York City is therefore \$3.33, or \$33.30 per carton.

19. Under New York law, cigarettes may not be sold by anyone other than a licensed wholesale dealer or registered retailer (*see* N.Y. Tax L. §§ 480, 480-a). Most wholesale cigarette dealers (and all of the defendants) are also “stamping agents,” that is, they are licensed by the State and City of New York to apply tax stamps on cigarettes to be sold in the State and City. (The terms “wholesaler” and “stamping agent” are used herein synonymously.)

20. All cigarettes sold in New York are presumed taxable until proven otherwise. *See* N.Y. Tax L. § 471(1). (“There is hereby imposed and shall be paid a tax on all cigarettes possessed in the state by any person for sale, except that no tax shall be imposed on cigarettes sold under such circumstances that this state is without power to impose such tax...”).

21. Every licensed stamping agent is required by law to pay the applicable taxes on each carton of cigarettes to be sold in the State. N.Y. Tax L. § 471(2). Licensed stamping agents provide proof of that they have paid the tax by affixing a State cigarette tax stamp to each package of cigarettes to be sold in the State, and a City tax stamp to each package of cigarettes to be sold in the City. *Id.*; 20 New York Codes, Rules and Regulations (“NYCRR”) § 76.1(a)(1); Admin. Code § 11-1302(g). The price of the tax stamp purchased by the stamping agent and affixed to the package is approximately equal to the amount of the tax paid on the cigarettes. By paying the tax and affixing the tax stamp to each package of cigarettes, the stamping agent thereby includes the tax in the selling price of the cigarettes. The tax burden then falls on each subsequent purchaser of the cigarettes in the distribution chain, and ultimately upon the consumer, as required under N.Y. Tax L. § 471(2).

22. In the limited circumstance in which a purchaser is exempt from paying cigarette tax, the person selling the cigarettes to the exempt buyer must obtain from the purchaser documentation establishing the purchaser's exemption. 20 NYCRR § 76.1 (c)(1). The seller must retain all certificates, documents or other proof of exemption supporting all of the seller's sales that are claimed to be exempt from tax. 20 NYCRR § 76.1(c)(1).

23. Cigarette taxes comprise a significant portion of the price of cigarettes sold in the State. When wholesalers fail to pay cigarette taxes and do not add the amount of the tax into the wholesale price of cigarettes, the subsequent retail price of the unstamped cigarettes is reduced by the amount of the unpaid tax – at times to less than half of the retail price of cigarettes on which taxes have been paid. Retailers therefore can profitably sell unstamped cigarettes for far less than the prices charged by retailers of tax-paid cigarettes. This illegal “discount” provides consumers with an enormous incentive to purchase unstamped cigarettes instead of tax-paid cigarettes.

#### **Sales of Cigarettes to Native Americans**

24. Native Americans are exempt from paying State or City cigarette taxes, but only on cigarettes purchased for their personal consumption and only on qualified tribal reservations. N.Y. Tax L. § 471-e(1)(a). Cigarettes sold by Native Americans or by “reservation cigarette sellers” for sale to the public (or even to non-members of the seller's nation or tribe) are not exempt from taxes. *Id.*

25. Effective March 1, 2006, New York law requires wholesalers to pay applicable cigarette taxes on all cigarettes sold to Native American “reservation cigarette sellers,” as defined under N.Y. Tax L. § 470(17). All such cigarettes must bear tax stamps, even if the sale is later established to have been tax-exempt. N.Y. Tax L. § 471-e(3)(c).

26. By requiring the payment of taxes and the application of tax stamps on *all* cigarettes sold at wholesale to reservation cigarette sellers, the statute is intended to eliminate the widespread diversion to non-Native Americans the unstamped cigarettes intended for personal consumption by Native Americans. Such diverted sales – often advertised as “tax-free” on the spurious basis of the seller’s location on a Native American reservation – are driven by the substantial price difference between stamped and unstamped cigarettes. The diversionary sales are made possible because of the large quantity of unstamped cigarettes, vastly in excess to what would be required for Native American personal consumption, made available to reservation cigarette sellers by defendants.

**Defendants’ Violations of Federal and State Cigarette Laws**

27. Despite the requirements of N.Y. Tax L. § 471-e and/or 20 NYCRR § 74.4(a), defendants, themselves and through agents and affiliated businesses, illegally sell unstamped (*i.e.*, non tax-paid) cigarettes at wholesale to reservation cigarette sellers and/or to other retail sellers who are not registered pursuant to the requirements of N.Y. Tax L. § 480-a (“unregistered cigarette retailers”). Additionally, despite the requirements of 20 NYCRR §76.1, defendants sell unstamped cigarettes to purchasers without obtaining and retaining the documentation establishing the purchasers’ entitlement to a tax exemption. Defendants have engaged in such activities prior to and after March 1, 2006 through the present.

28. Since March 1 2006, defendants have sold millions of cartons of unstamped cigarettes to reservation cigarette sellers and other unregistered cigarette retailers.

29. The quantity of cigarettes sold by defendants vastly exceeds the number of cigarettes that Native Americans could use for their personal consumption.

30. The sale of unstamped cigarettes to reservation cigarette sellers, which cigarettes are intended for subsequent resale to the general public, constitutes the principal

business of several of defendants. For example, defendant Day estimates that 80 percent of its wholesale business consists of sales to Indian cigarette vendors operating on tribal land. See Affidavit of Peter Day, President of Day, dated June 20, 2006, at ¶ 6, as submitted in *In the Matter of the Application of The County of Seneca v. Eristoff et al.*, (Supreme Court, County of Albany), Index No. 3172-06.

31. Many reservation cigarette sellers that obtain unstamped cigarettes from defendants then resell the unstamped cigarettes at retail locations, via the Internet or by telephone or mail to residents of the City. Defendants' sale of cigarettes at prices that do not include the cost of applicable tax stamps supports a thriving illicit market in cigarettes.

32. A review of online cigarette merchants who sell unstamped cigarettes to City residents shows the majority of them are or claim to be located in Native American territories. The conduct of these businesses is illegal twice-over: (1) Internet sales to residents of New York State are themselves illegal and (2) the sellers fail to pay and collect the taxes due at the time of sale. These online cigarette merchants operate lucrative businesses that are wholly dependent on a regular supply of unstamped cigarettes that wholesalers such as the defendants provide.

33. In addition, large quantities of unstamped cigarettes sold by defendants to retailers outside of the City are routinely trucked backed into the City for subsequent resale to City residents, either at retail locations or by street-corner "bottleleggers."

34. City residents also travel to Indian reservations to purchase unstamped cigarettes directly from the reservation cigarette sellers supplied by defendants. For example, the owner of the Poospatuck Smoke Shop and Trading Company (a reservation cigarette seller), Harry Wallace, has stated that his shop sells cartons of cigarettes to "a lot of Manhattanites" who

come to purchase unstamped cigarettes for themselves and for friends on the Indian reservation where the shop operates. See "Read Their Lips: No Taxes. (Period.)," *New York Times*, dated July 8, 2002.

35. A 2005 City Department of Health survey shows that perhaps as much as 15 percent of all cigarette smokers in the City purchase their cigarettes from Internet sellers, street sellers and reservation sellers. None of these sellers collect State and City excise and sales taxes.

36. The purchase by City residents of large quantities of unstamped cigarettes made available by defendants results in an enormous tax loss for the City. Purchases by City residents of unstamped cigarettes replace lawful cigarette transactions that would otherwise generate tax revenues for the State, and, in significant part, the City.

37. A 2004 report by the New York State Senate Committee on Investigations and Government Operations estimated that the sale of unstamped cigarettes deprived the State and its localities of as much as \$400 million in cigarette tax revenues in 2002 alone. See "Sales Tax Equity," Report by the New York State Senate Committee on Investigations and Government Operations, April 2004, at 6.

38. A 2006 draft report prepared for the State's Department of Health estimates that between \$436 million and \$576 million in taxes were lost in 2004 from the sale of untaxed cigarettes. "Untaxed cigarettes cost state \$436 million, study finds," Tom Precious, *Buffalo News*, June 27, 2006, available at <http://www.buffalonews.com/editorial/20060627/1026431.asp>.

### **The Contraband Cigarette Trafficking Act**

39. Pursuant to the Contraband Cigarette Trafficking Act, 18 U.S.C. § 2341 *et seq.*, (the "CCTA") "it is unlawful for any person knowingly to ship, transport, receive, possess, sell, distribute or purchase 'contraband cigarettes.'"

40. The CCTA defines "contraband cigarettes" as in excess of 10,000 cigarettes possessed by any person that bear no evidence of the payment of applicable State or local cigarette taxes in the State or locality where such cigarettes are found, if the State or local government requires a stamp to be placed on packages of cigarettes to evidence payment of cigarette taxes. 18 U.S.C. § 2341(2).

41. Defendants' knowing sale, transport distribution and shipment of unstamped cigarettes to reservation cigarette sellers in New York violates the CCTA in that the cigarettes are contraband: Cigarettes found in New York State bearing no evidence of the payment of New York State cigarette taxes.

### **Cigarette Marketing Standards Act**

42. Under the Cigarette Marketing Standards Act, N.Y. Tax L. § 483 *et seq.* (the "CMSA"), it is unlawful for any agent, wholesale dealer or retail dealer to sell cigarettes at prices that do not include the costs associated with the payment of all cigarette tax stamps required by law. N.Y. Tax L. §§ 483-484.

43. By selling unstamped cigarettes to reservation cigarette sellers in this State, the defendants violate the CMSA.

### **FIRST CLAIM FOR RELIEF**

#### **Violation of the Contraband Cigarette Trafficking Act**

44. The City realleges paragraphs 1-43 above as if fully set forth herein.

45. At all times relevant to this complaint, defendants have shipped, transported, sold, and distributed "contraband cigarettes" in New York State, as that term is defined by 18 U.S.C. § 2341(2). That is, each defendant has shipped, transported, sold, and distributed in excess of 10,000 cigarettes that do not bear the New York State cigarette tax stamps required by N.Y. Tax L. § 471-e and/or by 20 NYCRR § 74.4(a) to persons in this State who are not exempt from the requirements of such laws and regulations.

46. As a direct result of defendants' violations of the CCTA, the City has suffered damages. Defendants' unlawful sale of contraband cigarettes supports a thriving illicit market in cigarettes, throughout the State of New York, including New York City, thereby depriving both the State and the City of millions of dollars in cigarette tax revenues annually. As a result, the City has suffered injury in that it is deprived of tax revenue due to it in connection with each and every sale of cigarettes to City residents that results from defendants' violations of the CCTA.

47. Pursuant to 18 U.S.C. § 2346(b)(1), a local government may bring an action in the federal courts to prevent and restrain violations of the CCTA.

48. Pursuant to 18 U.S.C. § 2346(b)(2), a local government may in a civil action under 18 U.S.C. § 2346(b)(1) also obtain any other appropriate relief for violations of the CCTA from any person, including civil penalties, money damages, and injunctive or other equitable relief.

### **SECOND CLAIM FOR RELIEF**

#### **Violation of the Cigarette Marketing Standards Act**

49. Plaintiff repeats and realleges paragraphs 1-48 as if fully set forth herein.

50. Each of defendants qualifies as an "agent" within the meaning of the CMSA.

51. Each of defendants has repeatedly advertised, offered to sell and/or sold cigarettes for less than the "basic cost of cigarettes" within the meaning of § 483 of the CMSA by not including, as part of the price of the cigarettes, the full face value of the cigarette tax stamps required by New York law.

52. Pursuant to § 484(6) of the CMSA, the aforesaid advertisements, offers to sell and sales are prima facie evidence of each defendant's intent to avoid the collection of or paying over of taxes required under New York law.

53. Defendants' repeated sales of cigarettes to reservation cigarette sellers and/or unregistered cigarette retailers for less than the basic cost of cigarettes are not exempt from the requirements of the CMSA.

54. As a direct result of defendants' violations of the CMSA, the City has suffered injury in that defendants' sale of cigarettes at prices that do not include the costs of applicable tax stamps supports a thriving illicit market in cigarettes throughout the State of New York, including New York City, thereby denying both the State and the City millions of dollars in lost cigarette tax revenues. As a result, the City has suffered injury in that it is deprived of tax revenue due to it in connection with each and every sale of cigarettes to City residents that is facilitated by defendants' violations of the CMSA.

55. Pursuant to § 484(6)(b) of the CMSA, any person injured by any violation or threatened violation of the CMSA may bring an action to prevent, restrain or enjoin such violation or threatened violation and, in addition to such injunctive relief and costs of suit (including reasonable attorney's fees), may recover damages.

### **THIRD CLAIM FOR RELIEF**

#### **Public Nuisance**

56. Plaintiff repeats and realleges paragraphs 1-55 as if fully set forth herein.

57. Defendants are engaged in the business of selling unstamped cigarettes to reservation cigarette sellers who subsequently cause large quantities of such unstamped cigarettes to be resold to City residents, over the Internet, or by mail, fax and telephone.

58. The New York State Legislature has declared the shipment of cigarettes sold via the Internet or by telephone or by mail order to residents of this State to be "a serious threat to public health, safety, and welfare, to the funding of health care...and to the economy of the state," thereby defining such shipments as a public nuisance. N.Y. Public Health L. § 1399-II (legislative findings L. 200, ch 262, § 1).

59. Defendants, by selling or providing unstamped cigarettes to numerous reservation cigarette sellers for resale to the public via the Internet or by telephone or by mail order to City residents thereby create, supply, maintain and contribute to a public nuisance, and unreasonably and substantially interfere with rights common to the general public, with commerce and the quality of daily life and endanger the property, health and safety of large numbers of residents of this State and the City of New York.

60. Defendants' conduct further creates, supplies, maintains and contributes to a public nuisance in that unstamped cigarettes supplied by defendants are subsequently resold via the Internet or by telephone or by mail order to City residents who do not first demonstrate, through a driver's license or other photographic identification card issued by a government entity or educational institution, that they are persons of at least eighteen years of age as required under § 1399-cc(3) of the State's Public Health Law.

**WHEREFORE**, New York City respectfully prays that the Court grant judgment against defendants as follows:

- a. On the First Claim For Relief, pursuant to 18 U.S.C. § 2341 *et seq.*, enjoin defendants' violations of 18 U.S.C. § 2341 *et seq.*;
- b. On the Second Claim For Relief, pursuant to N.Y. Tax L. § 483 *et seq.*, enjoin defendants' violations of N.Y. Tax L. § 483 *et seq.*;
- c. On the Third Claim for Relief, enjoin defendants' continuing maintenance of a public nuisance by prohibiting defendants from selling or providing unstamped cigarettes and other tobacco products to customers within New York State;
- d. Award the City the amount of City excise and sales taxes lost as a result of defendants' violations of 18 U.S.C. § 2341 *et seq.* and N.Y. Tax L. § 483 *et seq.* in addition to the attorney's fees and costs incurred in bringing this action; and
- e. Award such other and further relief as the Court may deem appropriate.

JURY DEMAND

Plaintiff hereby demands a jury trial as to all issues of this suit.

Dated: New York, New York  
July 21, 2006

MICHAEL A. CARDOZO  
Corporation Counsel of the  
City of New York  
Attorney for Plaintiff The City of New York  
100 Church Street, Room 3-128  
New York, New York 10007  
(212) 788-1324

By: 

Eric Proshansky (EP 1777)  
Gail Rubin (GR 7833)  
Assistant Corporation Counsel

Of Counsel:  
Brad Snyder