

This memo sets forth the legislative strategy FGA will pursue to enact legislation banning the on-line retail sale of tobacco products. It also updates you on Internet initiatives currently underway at the FGA.

## **Background**

The number of on-line cigarette stores has more than doubled over the last year. It is estimated that in just five years, the on-line sale of cigarettes could account for 20% of all cigarette sales in America. The recent explosion of the on-line cigarette business has become a serious problem for youth smoking prevention and puts at risk millions of dollars in state tax revenue.

The boom in on-line cigarette retailing and the easy access it offers to minors threatens youth smoking prevention. These sites side-step regulations against sales to minors by taking only minimal steps to ensure that buyers meet the legal smoking age. In most cases, a minor may purchase on-line cigarettes by simply answering "yes" to the question: "click here to verify that you are at least 18 years of age." In a recent sting operation in Utah, minors between the ages of ten to 15 successfully purchased on-line cigarettes in 8 out of 15 times. Until technology exists that allows for government approved age verification over the Internet, it will remain impossible to stop teenagers from buying on-line cigarettes.

In addition, the on-line tobacco market directly threatens state treasuries by evading state excise and sales taxes. The on-line discounters generally operate either from low tobacco-tax states such as Virginia, or from Native American reservations, where cigarettes can be bought without the 34-cent-a-pack federal excise tax. In both cases, consumers save money because they pay no sales taxes to their home jurisdiction. For example, a consumer in California where a carton of Marlboros costs \$36.55 can purchase an identical carton over the Internet through cigsbymail.com for \$20.55. Over time, this could result in hemorrhaging revenue losses for the states and pose a severe threat to the wholesale and distribution chain into which Philip Morris has invested billions of dollars. In fact, state governments across the country are already claiming losses in the millions from on-line cigarette sales over the past year.

Many consumers do not realize that states have the authority to pursue tax collection from on-line cigarette sales because such transactions are not protected under the Internet Tax Freedom Act, which prohibits states from imposing taxes on Internet transactions. The California Board of Equalization is pursuing tax collection from Californians who purchased tax-free cigarettes from out of state on-line retailers at any time during 1999. Unfortunately, states are finding that enforcing payment of a state tax is difficult because most owners of on-line stores usually do not report buyers' names.

## **Situation Analysis**

Legislative efforts were made last year to restrict the on-line sale of all age-restricted products, specifically alcohol and cigarettes. Representative Martin Meehan (D-MA) introduced two bills to regulate the sale of tobacco products over the Internet. The first bill applies warning labels to Internet sales, and the second federalizes 18 as the minimum age for the Internet sale of tobacco products. Also, during Conference consideration of the Juvenile Justice bill, Representative John Shimkus (R-IL) attempted to add language ensuring that any product or service sold via the Internet that requires age verification through any other venue would also require age verification by the delivery service. State governments are also taking steps to restrict the Internet sale of tobacco. In Utah,

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legislation is being pushed to prohibit any on-line distributor from selling cigarettes to minors in Utah. Also, five Internet retailers have agreed to halt the sales of bidis, a flavored cigarette from India, after the Attorneys General from 13 states wrote letters threatening to sue the companies if sales to minors did not cease.

Philip Morris believes that any retail sale of tobacco products to consumers should be a face to face transaction where age can be properly verified. Notwithstanding the source of the sales, Philip Morris suffers the negative ramifications of youth smoking. Enacting legislation to ban Internet tobacco sales will further our efforts on youth smoking prevention and will save the states millions of dollars in tax revenue. While this legislation politically seems like an easy win, we should be prepared for major opposition. The Native American groups and other discount cigarette retailers will no doubt oppose any effort to thwart their thriving on-line business. We should also expect opposition from our more traditional allies, such as the conservative policy organizations and some Members of Congress, based on their fundamental belief that no regulations should be placed on the Internet or e-commerce trade. This issue, however, provides Philip Morris with an unprecedented opportunity to work constructively with our non-traditional allies in trying to enact responsible legislation.

### **Objectives**

- Enact federal legislation that prohibits the retail sale of tobacco products over the Internet.
- Preserve future e-commerce trade between PMUSA and our wholesalers, distributors and large retail chains.

### **Strategy**

FGA is pursuing the following strategy:

Attach Internet restriction to appropriate legislative vehicle on the House or Senate floor, therefore avoiding committee consideration. Secure support for such action through development and mobilization of non-traditional allies. Allow youth smoking prevention to drive debate rather than business considerations.

### **Tactics**

- Develop legislation. Arnold & Porter is currently working on language which is under review at PMUSA.
- Secure industry/ally support. Build coalition using grey-market model.
- Identify and expand non-traditional ally base. Allies to include Attorneys General, states and youth advocates.
- Clear with distribution chain.
- Attach Internet bill as a "rider" to most viable legislative vehicle. This could be Internet Gambling legislation that has passed the Senate and is currently moving through the House. The President has indicated support for Internet Gambling legislation. Other possibilities include Internet signature legislation or related vehicles.

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- Articulate to House and Senate leadership that moving this issue forward is a political winner.
- Schedule meeting with Chairman Bliley early in the year. During Conference consideration of the Juvenile Justice bill he indicated he that he opposed any effort to restrict the on-line sale of cigarettes.
- Brief House Rules Committee Chairman Drier and monitor any possible legislative vehicles moving through that committee.
- Brief allies on Capitol Hill.
- Coordinate with state governments in articulating the huge loss in state tax revenue resulting from on-line cigarette sales.
- Prepare for opposition from Native American retailers and discount tobacco retailers.
- Coordinate with Attorneys General and state legislators' Internet ban initiatives.

#### **Key Needs**

- Amount of state taxes at risk to on-line sales
- Total loss in state revenue to Internet sales in 1999

#### **Estimated Timeline**

- Calendar Year 2000
- Before the end of Second Session

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