November 1, 2013

Honorable Edward J. Kasemeyer, Chairman Senate Budget and Taxation Committee
Honorable Norman H. Conway, Chairman of the House Appropriations Committee

Gentlemen:

The “Direct Tobacco Shipper’s Permit and Common Carrier Permit Study” is submitted as required on page 27 of the 2013 Joint Chairmen’s Report. The report provides information on the implementation of the permits for the direct shipment of wine and certain other tobacco products.

The information contained in the report was compiled by the Field Enforcement Division of the Office of the Comptroller. I extend my appreciation to all those involved with this effort.

Sincerely yours,

Peter Franchot
I. **Objectives of the Study and Current Maryland Law**

The 2013 Joint Chairmen’s Report on the Fiscal 2014 State Operating Budget (HB100) and the State Capital Budget (HB 101) and Related Recommendations requested that the Comptroller, in consultation with the Office of the Attorney General, report on the direct sale and shipment to consumers of pipe tobacco and premium cigars. Included in the report are:

- A review of safeguards or other measures currently used by out-of-state retailers to ensure compliance with state laws regarding minimum age for the purchase of tobacco products, including any procedures used when a consumer is not present at time of delivery;
- A review of other state laws regulating minimum age requirements for the purchase of alcohol and tobacco from out-of-state retailers;
- The estimated amount of total annual sales of premium cigars and pipe tobacco in Maryland;
- The methods of delivery currently used in Maryland by out-of-state retailers of premium cigars and pipe tobacco;
- A review of compliance with current Maryland law on the minimum age for alcohol use under the direct wine ship law;
- The economic impact of out-of-state sales of premium cigars and pipe tobacco on Maryland retailers; and,
- A review of information provided in “On the Need for Consistent Tobacco Tax Collection in Maryland” - (Sage Policy Group, March 2013).

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1 Report on the Fiscal 2014 State Operating Budget (HB 100) and the State Capital Budget (HB 101) and Related Recommendations, available at http://mgaleg.maryland.gov/Pubs/BudgetFiscal/2013rs-budget-docs-jcr.pdf
Currently, statutes that pertain to the direct sale and shipment to consumers of pipe tobacco and premium cigars are:

1) Business Regulation, Title 16.5, Subtitle 1, Section 16.5-103 Applicability of subtitle, which reads as follows:

“Notwithstanding any other provision of this title, this title does not apply to a seller located outside the State when selling, holding for sale, shipping, or delivering premium cigars or pipe tobacco to consumers in the State,”

and

2) Business Regulation, Title 16.5, Subtitle 2, Section 16.5-217 Sales or distribution of other tobacco products, which reads as follows:

(a) Applicability of section.—“This section applies to a person who is engaged in the business of selling or distributing other tobacco products”.

(b) Prohibition, exception.—

(1) This subsection does not apply to the order, purchase, sale, or shipment of premium cigars or pipe tobacco by a licensed other tobacco products retailer or licensed tobacconist.

(2) Except as provided in paragraph (3) of this subsection, a person covered under this section may not:

(i) sell or ship other tobacco products, ordered or purchased by mail or through a computer network, telephonic network, or other electronic network by a consumer or other unlicensed recipient, directly to a consumer or other unlicensed recipient in this state; or
(ii) cause other tobacco products, ordered or purchased by mail or through a computer network, telephonic network, or other electronic network by a consumer or other unlicensed recipient, to be shipped directly to a consumer or other unlicensed recipient in this State.

(3) A licensed other tobacco products retailer or licensed tobacconist may deliver not more than two packages of other tobacco products directly to a consumer if the delivery is made by the licensed other tobacco products retailer or licensed tobacconist or an employee of the licensed other tobacco products retailer or licensed tobacconist.²

II. **Review of Safeguards or Other Measures Currently Used by Out-of-State Retailers to Ensure Compliance with State Laws Regarding Minimum Age for the Purchase of Tobacco Products, Including Any Procedures Used When a Consumer Is Not Present at Time of Delivery**

**Out-of-State Retailers**

In Maryland, premium cigars and pipe tobacco are the only tobacco products that legally may be shipped directly to a consumer by an out-of-state retailer. Cigarettes and all other types of tobacco products may not be shipped directly to a consumer. All out-of-state retailers who ship premium cigars and pipe tobacco to consumers in Maryland require the consumer to affirmatively indicate that he or she is at least 18 years of age which is Maryland’s legal age for purchasing tobacco. Most states require that purchasers be at least 18 years old at the time of purchase, but a few states require purchasers to be 19 years old resulting in some retailers requiring all purchasers to be 19 years old or older in every state.

Most retailers use an independent age verification service, such as Veritad, to verify the purchaser’s age. These systems use a combination of public records to develop a series of personal knowledge multiple choice questions that, presumably, only the purchaser could answer. If the age cannot be verified through these systems, the retailers require direct telephone contact to attempt other means of verifying the purchaser’s age, generally by obtaining a copy of a driver’s license or some other government identification with photograph.

While out-of-state retailers of premium cigars and pipe tobacco work to verify the age of purchasers during the ordering process, there are no statutory requirements for the delivery agent to verify the age of the recipient.

III. **Review of Other State Laws Regulating Minimum Age Requirements for the Purchase of Alcohol and Tobacco from Out-of-State Retailers**

The National Minimum Drinking Act of 1984 required all states to raise their minimum purchase of alcohol age to 21 or face a reduction in highway funds under the Federal Highway Aid Act and so, eventually, all 50 states raised the legal drinking age to 21 where it remains today.³

For tobacco purchases, United States customers must be 18 years of age or older in every state except for those in Alaska, Alabama, New Jersey, New York, or Utah where the minimum age is 19.

In Maryland, wine is the only alcohol that may be shipped directly to a consumer, and premium cigars and pipe tobacco are the only tobacco products that may be shipped directly to a consumer.

IV. **Estimated Amount of Annual Sales of Premium Cigars and Pipe Tobacco in Maryland.**

In Fiscal Year 2012, the year for which data is most recently available, $12.8 million in excise tax was collected on Other Tobacco Products (OTP) including premium cigars and pipe tobacco. Data

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indicates that cigars comprise 61% of the OTP sold in the state, with premium cigars accounting for
21% of the total cigars sold. Pipe tobacco sales make up 1.9% of the total OTP excise tax receipts.

Based on the above data and estimates, $1,639,680 in excise tax was collected in FY2012 from
sales of premium cigars and $243,200 in excise tax from sales of pipe tobacco. During the year this
data was collected, the OTP excise tax rate was 15% of the wholesale cost. Therefore, the estimated
amount of annual premium cigar sales at wholesale was $10,931,200 and the estimated amount of
annual pipe tobacco sales at wholesale was $1,621,333. It is important to specify that this data reflects
sales reported by in-state Maryland licensees, it does not include any sales made by out-of-state
retailers and shipped into Maryland as there are no reporting requirements for those transactions.

V. Methods of Delivery Currently Used in Maryland by Out-of-State Retailers of Premium
Cigars and Pipe Tobacco.

United States Postal Service and Common Carriers

When placing an order for premium cigars or pipe tobacco from an out-of-state retailer, the
only choices of delivery agent for consumers are the United States Postal Service (USPS), UPS,
and FedEx.

The Prevent All Cigarette Trafficking (PACT) Act, signed by the President and effective June
29, 2010, (mentioned in the STUDY ON THE SHIPMENT OF OTHER TOBACCO PRODUCTS
IN MARYLAND - November 2012), put some requirements on the methods used to deliver
cigarettes and smokeless tobacco to consumers. As Maryland only permits the shipping of
premium cigars and pipe tobacco to consumers, the remainder of this report will refer to only those
two items and the shipping of them into Maryland.
The PACT Act requires the verification of the age of the purchaser and the recipient. However, since cigars and pipe tobacco are not included in the Act, there is no such age verification requirement.

**United States Postal Service**

With few exceptions, the United States Postal Service (USPS), as a result of the PACT Act, is banned from shipping cigarettes and smokeless tobacco. However, as the PACT Act does not address the shipping of cigars and pipe tobacco, they are still “mailable” and deliverable directly to consumers with no age verification requirement.

**UPS**

UPS mentions that it does not ship cigarettes to consumers, however it does not make the same statement concerning cigars or pipe tobacco. Additionally, most out-of-state retailers offer a variety of UPS delivery options for consumers.

**FedEx**

According to FedEx, FedEx does not ship any tobacco products from a retailer to a consumer. FedEx only will ship tobacco products from one authorized entity to another authorized entity; in other words, from one properly licensed business to another. However, in reviewing a variety of out-of-state retailers’ ordering platforms, FedEx was offered as a delivery option on one of them. It is possible FedEx was referring to cigarettes and smokeless tobacco when stating it did not ship tobacco products to consumers.

**Random Sampling**

For this study, several out-of-state suppliers of premium cigars and pipe tobacco were randomly selected to determine their method of delivery to Maryland consumers. Most companies,

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such as Cigars Direct\(^5\), Gotham Cigars\(^6\), and JR Cigars\(^7\), Thomson Cigar, use UPS and the USPS. SeriousCigars.com advertises the use of both FedEx and the USPS.\(^8\)

VI. **Compliance with Current Maryland Law on the Minimum Age for Alcohol Use Under the Direct Wine Ship Law.**

Under Article 2B – Alcoholic Beverages §7.5–109(a), “[t]o receive a direct shipment of wine, a consumer in the State shall be at least 21 years old.” As of the date of this report, there have been no incidents reported to the Office of the Comptroller where underage persons illegally have received wine through the direct wine shipment framework. Additionally, there have been no significant complaints specific to the law or its implementation from the alcohol industry, permit holders, or consumers in the 28 months since the law took effect.

VII. **Economic Impact of Out-Of-State Sales of Premium Cigars and Pipe Tobacco on Maryland Retailers and a Review of Information Provided in “On the Need for Consistent Tobacco Collection in Maryland” (Sage Policy Group, March 2013).**

The Premium Cigar Retailers Association of Maryland hired Sage Policy Group, (Sage) to conduct a study of Maryland’s market for premium cigars. A component of the study was a survey and analysis of the impact on sales during the nearly two-month ban on the shipment of premium cigars that occurred in May 2011 and June 2011, as compared to sales over the same period of the previous year. The analysis of the data seemed to suggest that premium cigar sales increased 13.9% and 19.3% for May and June in 2011, respectively, with a cumulative increase of 16.7% over the same period sales in 2010. Prior to the ban, year-over-year sales were expanding at a 7.6% rate. However,

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\(^{5}\) Cigars Direct, available at http://www.cigarsdirect.com
\(^{8}\) SeriousCigars.com available at http://www.seriouscigars.com/privacy_policy.aspx
what is not clear is if the increased sales percentages that the premium cigar sellers experienced during the ban continued when the ban was lifted or if the sales percentages retreated to pre-ban rates.

Using estimated data and the result of the survey, the report concluded that in addition to the uneven playing field on which the in-state premium cigar sellers find themselves, Maryland foregoes tax revenues in excess of $2.2 million.
## Index

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Objectives of the Study and Current Maryland Law</td>
<td>1</td>
</tr>
<tr>
<td>II. Review of Safeguards or Other Measures Currently Used by Out-of-State Retailers to Ensure Compliance with State Laws Regarding Minimum Age for the Purchase of Tobacco Products, Including Any Procedures Used When a Consumer is Not Present at Time of Delivery</td>
<td>3</td>
</tr>
<tr>
<td>III. Review of Other State Laws Regulating Minimum Age Requirements for the Purchase of Alcohol and Tobacco from Out-of-State Retailers</td>
<td>4</td>
</tr>
<tr>
<td>IV. Estimated Amount of Annual Sales of Premium Cigars and Pipe Tobacco in Maryland</td>
<td>4</td>
</tr>
<tr>
<td>V. Methods of Delivery Currently Used in Maryland by Out-of-State Retailers of Premium Cigars and Pipe Tobacco</td>
<td>5</td>
</tr>
<tr>
<td>VI. Compliance with Current Maryland Law on the Minimum Age for Alcohol Use Under the Direct Wine Ship Law</td>
<td>7</td>
</tr>
<tr>
<td>VII. Economic Impact of Out-of-State Sales of Premium Cigars and Pipe Tobacco on Maryland Retailers and a Review of Information Provided in “On the Need for Consistent Tobacco Collection in Maryland” (Sage Policy Group, March 2013)</td>
<td>7</td>
</tr>
</tbody>
</table>