



NEW YORK CITY LAW DEPARTMENT  
OFFICE OF THE CORPORATION COUNSEL

Michael A. Cardozo, Corporation Counsel

Press Release

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For Immediate Release

**NEW YORK CITY COMMENCES SUIT AGAINST INTERNET CIGARETTE SELLERS  
UNDER THE FEDERAL RACKETEERING STATUTE, SEEKS TO RECOVER IN  
EXCESS OF \$15 MILLION**

***INTERNET CIGARETTE SELLERS' CONCEALMENT OF SALES FROM STATE TAX AUTHORITIES AND  
MISREPRESENTATION OF TAX STATUS OF INTERNET CIGARETTE PURCHASES RESULTS IN CITY SUIT UNDER  
FEDERAL RICO STATUTE FOR INJUNCTION AND TREBLE DAMAGES.***

**Contact: Kate O'Brien Ahlers, Communications Director, (212) 788-0400, [kahlers@law.nyc.gov](mailto:kahlers@law.nyc.gov)**

New York, January 17, 2003 -- Corporation Counsel Michael A. Cardozo and Commissioner of the Department of Finance Martha E. Stark announced today that the City had filed a lawsuit in the Federal District Court in Manhattan against corporations and individuals that operate Internet sites for the sale of cigarettes. The City's suit seeks treble or triple the amount of the taxes the City has lost by reason of the defendants' unreported sales to New York City residents -- which could amount to in excess of \$15 million in recovery for the City -- and an injunction that would require the defendants to file the federally mandated Jenkins Act reports and to desist from continuing to misrepresent the tax status of Internet purchases.

The City's complaint alleges that the defendants, who own or control approximately 15 Internet websites from which cigarettes may be purchased, have devised a massive tax evasion scheme to defraud State and local governments of cigarette tax revenues. The complaint alleges that defendants withhold the federally-mandated Jenkins Act reports that alert state tax authorities to out-of-state cigarette purchases, so that the purchases can be taxed. The complaint also alleges that Internet sellers assure customers that purchases will be concealed from state tax authorities. According to the complaint, some defendants also routinely and falsely state that cigarettes sold to New Yorkers over the Internet are "tax free," despite New York City and State laws requiring purchasers to pay cigarette excise and sales taxes on cigarettes purchased for use in the state.

The complaint alleges that the Internet cigarette sellers' conduct is chargeable under federal mail and wire fraud statutes and for this reason violates the federal RICO (Racketeer Influenced and Corrupt Organizations) statutes. The complaint also charges violations of state law outlawing deceptive consumer transactions.

Corporation Counsel Cardozo said of the City's lawsuit, "We must take aim at those who are illegally selling cigarettes without paying the appropriate taxes. The illegal activities of the defendants are causing New York City to lose millions of dollars in tax revenue. The City's lawsuit relies on well-established federal law that provides a powerful means to strike back at Internet sellers, who now openly flout the law and deprive State and local governments nationwide of hundreds of millions in tax revenues. Internet sellers that fail to comply with the Jenkins Act will find themselves paying triple the amount of their customers' taxes."

Commissioner Stark said, "People who conspire to cheat the City out of its due must be held accountable, because these taxes fund critical services on which we all rely. Finance has aggressively stepped up its efforts to enforce the cigarette tax laws, assigning tax enforcement staff and deputy sheriffs to perform spot-checks of retailers and increase our surveillance in and around New York City, especially near schools."

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The defendants in the case are identified as:

- Cyco.net, Inc., 4201 Yale Blvd NE, Suite G, Albuquerque, NM 87107 and 400 Gold SW #980, Albuquerque, NM 87102, owner of retail cigarette websites at [www.cycocigs.com](http://www.cycocigs.com) and [www.aabakismokes.com](http://www.aabakismokes.com). Approximately 40 percent of Cyco.net's Internet sales are to New York residents.
- Richard A. Urrea, Brent Wolford, and Daniel R. Urrea, respectively President, Chief Technical Officer and Chief Financial Officer of Cyco.net.
- Hemi Group, LLC, 250 Sheep Springs Circle, Jemez Pueblo, NM 87024, owner of retail cigarette websites at [www.buydiscountcigarettes.com](http://www.buydiscountcigarettes.com), [www.cigarettespecials.com](http://www.cigarettespecials.com), [www.FreeCigs4u.com](http://www.FreeCigs4u.com) and [www.cybercigarettes.com](http://www.cybercigarettes.com) and [www.adobeCigarettes.com](http://www.adobeCigarettes.com).
- Kai Gachupin, an officer of Hemi Group LLC.
- Dirtcheapcig.com, Inc. 900 McGuire Ave. Suite C, Paducah, KY 42001, owner of an Internet cigarette website at [www.dirtcheapcig.com](http://www.dirtcheapcig.com).
- Fred W. Teutenberg IV, President of Dirtcheapcig.com, Inc.
- Fred W. Teutenberg V, an employee of Dirtcheapcig.com, Inc.
- Michael E. Smith, doing business as PaylessCigs, 717 West 33rd St., Richmond, VA 23225 owner of an Internet cigarette website at [www.paylesscigs.com](http://www.paylesscigs.com).
- Hooray's, Inc., 12619 Shelbyville Rd., Louisville, KY 40243, owner of retail cigarette websites at [www.smokes-direct.com](http://www.smokes-direct.com) and [www.cigsonline.com](http://www.cigsonline.com).
- Stephen F. Knopp, President of Defendant Hooray's Inc.
- Dmitriy Zilberman, Site Administrator of the Hooray's, Inc. websites.
- S4L Distributing, Inc., 1514 E. 3<sup>rd</sup> Avenue, Big Stone Gap, VA 24219, owner of Internet cigarette websites at [www.bulkcigs.com](http://www.bulkcigs.com), and [www.S4L.com](http://www.S4L.com).
- William C. Baker III, Site Administrator of the S4L, Inc. websites.
- Double B Distributing d/b/a Discount Tobacco Store, 113 E. Jackson St., Gate City, VA 24251, owner of an Internet cigarette website at [www.discounttobaccostore.com](http://www.discounttobaccostore.com).
- William J. Bevin, owner of an Double B Distributing, d/b/a/ Discount Tobacco Store.

The City and State of New York each impose an excise tax on all cigarettes possessed for sale or use within the State and City of New York. Cigarette taxes of other states are generally lower than New York's, allowing out-of-state retailers to offer cigarettes at lower prices than prevail at the City's "brick and mortar" stores.

"While out-of state sellers are now easily accessible to New York City residents over the Internet, the 'savings' they offer is an example of the adage that a deal that looks too good to be true probably isn't," noted Eric Proshansky, Deputy Division Chief of the Law Department's Affirmative Litigation Division. Proshansky is overseeing the legal filings on the case with Gail Rubin, the Law Department's Affirmative Litigation Chief. He added, "New York law requires that New York residents who purchase cigarettes out of state or over the Internet for use in New York pay tax on the purchases."

Rubin said, "The underlying assumption of the Internet cigarette business is that the purchasers will evade the tax imposed by their home states, because if the purchasers pay the tax, the price difference available from an Internet purchase essentially disappears." She added, "Because the success of the defendants' businesses relies almost entirely on customer tax evasion, Internet cigarette sellers do everything they can to promote and assist that tax evasion."

The Internet sellers' crucial role in cigarette tax evasion is their refusal to comply with the Jenkins Act, 15 U.S.C. §§ 375-378, a federal statute enacted expressly to combat interstate tax avoidance. The Jenkins Act requires interstate shippers of cigarettes to report out-of-state cigarette purchases to the tax authorities of the states to which shipments are made.

Recent published reports make clear that the illegal actions of Internet cigarette sellers cost State and local governments nationwide hundreds of millions of dollars every year, with analysts suggesting as much as an \$800 million tax loss by 2005. While the defendants' concealment of the sales makes a determination difficult, the loss to New York City and State from their fifteen defendants' web-sites alone may exceed ten million dollars per year.

The United States General Accounting Office has concluded that most Internet cigarette sellers do not comply with the Jenkins Act. (*Internet Cigarette Sales: Giving ATF Investigative Authority May Improve Reporting and Enforcement*, GAO Report 02-742 (August 2002). Most sellers -- including all of the sites maintained by the defendants in the City's suit -- inform customers that the sellers withhold sales data from state tax administrators, openly assuring customers' that their "savings" will be protected through concealment of the sales. Paylesscigs, one of the sites involved in the City's suit, assures its customers:

We do not provide your information to anyone! Most other cigarette sites don't either, but a few do report sales to state tax offices, so find out before you buy, if not you could receive an unexpected tax bill from your state tax office.

Many Internet sites, including those controlled by several of the defendants in the City's action, even offer bogus 'legal opinions' that the sellers are not required to comply with the Jenkins Act.

Internet cigarette sellers, including several of the defendants in the City's action, also mislead their customers into believing that no taxes are owed on Internet purchases, giving false assurances on their websites or in telephone communications that the cigarettes are "tax-free" and that purchasers are not required to pay State and local taxes. Defendant Cyco.net, for example, maintains a website stating in bold letters that "All sales are tax free!!"

The defendants' conduct violates the federal racketeering statutes, entitling the City to recover three times its actual losses and attorney fees. The City estimates that recovery could exceed \$15 million. The City also seeks an injunction requiring the defendants to file Jenkins Act reports in the future, to inform their customers of the filings and to accurately inform customers of the taxability of the purchase.

The New York City Law Department is one of the oldest, largest and most dynamic law offices in the world, ranking among the top three largest law offices in New York City and the top three largest public law offices in the country. Tracing its roots back to the 1600's, the Department's 650-plus lawyers handle more than 100,000 cases and transactions each year in 17 separate legal divisions. The Corporation Counsel heads the Law Department and acts as legal counsel for the Mayor, elected officials, the City and all its agencies. The Department's attorneys represent the City on a vast array of civil litigation, legislative and legal issues and in the criminal prosecution of juveniles. Its web site can be accessed through the City government home page at [www.nyc.gov](http://www.nyc.gov) or via direct link at [www.nyc.gov/html/law/home.html](http://www.nyc.gov/html/law/home.html).

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