



NEW YORK CITY LAW DEPARTMENT  
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Press Release

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*For Immediate Release*

**CITY MOVES FORWARD WITH LEGAL CASE AGAINST UNSCRUPULOUS  
INTERNET CIGARETTE DEALERS UNDER THE RACKETEERING STATUTE**

***DECISION IN COURT TODAY PERMITS CITY LAWSUIT TO PROCEED AGAINST INTERNET CIGARETTE  
SELLERS' MISREPRESENTATION OF TAX STATUS OF INTERNET PURCHASES***

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New York, January 27, 2005 – A Federal district court judge issued a ruling today that will permit the City's treble-damage racketeering suit against Internet cigarette sellers to proceed, ensuring that the City's efforts to protect the public against unscrupulous Internet cigarette dealers can continue.

"This ruling bolsters the City's efforts to prevent Internet cigarette vendors from misleading the public into illegal transactions," noted Corporation Counsel Michael A. Cardozo. "The City's initiatives are critical, because they will protect consumers from being duped by merchants who falsely and illegally advertise cigarettes as 'tax free.' The suit will also help prevent false advertising, it will benefit local businesses who are losing revenue to these illegal sellers, and it will aid the City in collecting revenue that benefits the broader public."

As required by regulators, the City recently sent tax notices to consumers who had inadvertently not paid taxes on prior purchases of cigarettes on the Internet. "The legal case that's moving forward today ensures that the real culprits – the illegal Internet cigarette sites – are held accountable, so that consumers are not surprised by taxes that they did not realize they owed," Cardozo noted. "This will help prevent illegal transactions that will result in fines from the Department of Finance."

Today's ruling, by District Judge Deborah A. Batts in the case, *The City of New York v Cyco.Net, Inc. et al., CV 03-0383(DAB)*, was issued in one of the City's four pending suits against a total of approximately 55 individual and corporate defendants who operate more than 30 Internet sites for the sale of cigarettes to New York City residents and others. Although today's ruling applies to only one of the City's four lawsuits, it will serve as precedent for the remaining suits in which defendants have filed similar motions to dismiss.

The complaint filed by the City alleged that the defendants intentionally do not file the required reports that are intended to alert tax authorities to out-of-state cigarette purchases, so that the purchases can be taxed. By concealing the sales, the Internet sellers make it impossible for the City to collect the cigarette excise taxes owed by the purchasers, thereby defrauding the City and the consumers who may not have realized that taxes were owed. Many of the defendants falsely advertised that purchases of cigarettes on their Internet sites were "tax free." The defendants filed motions to dismiss the actions, claiming that the New York courts did not have personal jurisdiction over them and that the City has failed to make out a claim under the racketeering statute and under State law.

In a 91-page opinion, the Court ruled that, other than an easily remedied "mis-description" of the so-called racketeering "enterprise," the City had met its burden of showing that the defendants' conduct, if proven,

amounts to a violation of the Federal mail and wire fraud statutes. Because the complaint alleges that the defendants were associated into an “enterprise” and that the defendants committed violations constituting a “pattern,” the conduct violates the Racketeer Influenced Corrupt Organization statute, popularly known as the RICO statute.

Specifically, the Court found that:

- The Court had jurisdiction over all of the individual and corporate defendants.
- The complaints describes the defendants’ fraud with the detail required under the Rules of Civil Procedure.
- The defendants’ failure to file the reports was a misrepresentation amounting to mail fraud.
- The City was defrauded of the money or property necessary to make out a mail fraud claim because taxes owed to the City constitute City “property.”

The Court did find what amounts to a technical pleading imperfection in the manner in which the various defendants were described to form the RICO enterprise, and required that aspect of the complaint to be amended – something that City lawyers predict will be remedied within days. The Court also ruled that the City could not bring State law claims under New York’s General Business Law, which it found was generally to be utilized by individual consumers for common law fraud.

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. Because the cigarette taxes of other states are generally lower than New York’s, out-of-state retailers are able 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 tout is an example of the adage that ‘a deal that looks too good to be true’ probably isn’t,” noted Eric Proshansky, Deputy Chief of the Law Department’s Affirmative Litigation Division and the City’s chief lawyer on the case. “New York law requires New York residents who purchase cigarettes out of state for use in New York to declare and pay tax on those purchases.”

The Internet sellers’ most important role in cigarette tax evasion is their refusal to comply with a statute enacted expressly to combat interstate tax avoidance by requiring interstate shippers of cigarettes to report all shipments to the tax authorities of the states to which shipments are made.

The United States General Accounting Office, in a report entitled, “Internet Cigarette Sales: Giving ATF Investigative Authority May Improve Reporting and Enforcement” (GAO Report 02-742 (August 2002), found that most Internet cigarette sellers do not comply with this law. Many sites inform customers that they actively withhold sales data from state tax administrators. Internet sellers often openly assure their customers’ that any failure to declare and pay taxes will go undetected, because of the defendants’ practice of not reporting the sales.

Studies by the City’s Health Department using sales data turned over in connection with lawsuits against Internet cigarette sellers have demonstrated that New York City and State are a principal target of Internet cigarette sellers and that the tax losses to the City and the State likely exceed \$100 million dollars per year.

Attorneys working on the case with Proshansky included Joshua P. Rubin, Senior Counsel, and Richard J. Costa, Senior Counsel, of the Law Department’s Affirmative Litigation Division.

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 90,000 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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