

2009 TTB Expo Presentation

# Tobacco Regulation Under the Internal Revenue Code

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# Overview

- Introduction to Tax and Regulation under the Internal Revenue Code of 1986 (IRC), including the Federal Excise Tax, Floor Stocks Tax, and Special Occupational Tax
- Mechanics of the Excise Tax, including bonds, claims, inventory, recordkeeping and reporting provisions
- Discussion of Permits and Penalty Provisions

# Brief History of Federal Tobacco Tax

- First tax in 1791
- Then again in 1812
- Then again in 1862
- In 1868, tax was first collected by stamp
- In 1958, present system of paying Federal excise tax by return was implemented at the initiative of the tobacco industry



Statutory Authority

Codified at

Chapter 52 of the Internal Revenue

Code of 1986 (IRC)

(Title 26 of the

United States Code)

# Regulations

- Title 27 of the Code of Federal Regulations –  
Parts:
  - 40 (Manufacture)
  - 41 (Importation)
  - 44 (Exportation)
  - 45 (Government Use)
  - 46 (Misc.)

# Excise Tax Rates

Small Cigarettes	\$50.33/1,000
Large Cigarettes	\$105.69/1,000
Small Cigars	\$50.33/1,000
Large Cigars \$0.4026/cigar max	52.75% of sales price
Snuff	\$1.51/lb
Chewing Tobacco	\$0.5033/lb
Pipe Tobacco	\$2.8311/lb
Roll Your Own	\$24.78/lb
Cigarette Papers	\$0.122/50
Cigarette Tubes	\$0.244/50

## Excise Tax Rates (Continued)

- Current rates as of April 1, 2009 per Title VII of the Children's Health Insurance Program Reauthorization Act of 2009, Pub L. No 111-3, dated February 4, 2009 (CHIPRA)
- Rates codified at 26 U.S.C. 5701; products defined at 26 U.S.C. 5702

# Floor Stocks Tax

- CHIPRA imposed a one-time floor stocks tax on tobacco products (except for large cigars) which were removed before April 1, 2009, and held on such date for sale by any person.
- The tax is equivalent to the difference in the amount that would be payable under the increased tax rates in April and the amount payable under the lower rates beforehand.
- Returns must be filed and the tax must be paid on or before July 31, 2009. The required April inventories should have been completed already. See 27 CFR Part 46 and the TTB Web site for floor stocks tax instructions.

# Payment of Excise Tax

**26 U.S.C. 5703**

- Federal excise tax:
  - Attaches when the product comes into existence or is imported into the United States.
  - Becomes due and payable when the product is removed from bonded premises.
  - Is paid by manufacturer on the basis of a semi-monthly return (special rule for September).
  - Electronic Funds Transfer required for taxpayers with annual liability of \$5,000,000 or more. Use of EFT encouraged for all taxpayers.

# Transfers In Bond

- A manufacturer may be relieved of liability when it transfers product in bond to another manufacturer or to an export warehouse proprietor; the transferee then becomes liable for the tax.
- A manufacturer or export warehouse proprietor is relieved of liability when tobacco products are exported.  
See 27 CFR Part 44.
- Importers may transfer product in bond to manufacturers and for Customs bonded warehouse (CBW) entry. For such CBW entry, the last day for payment of tax on product destined for domestic commerce shall be no later than the 14th day after the last day of the semi-monthly period during which the product is removed from the 1st such warehouse. See 26 U.S.C. 5703(b)(2)(B)(ii).

# Bond Requirements

- No one may operate as a manufacturer of tobacco products or of cigarette papers and tubes, or as an export warehouse proprietor without a bond approved by TTB. A bond ensures that the government will be paid some designated portion of the excise taxes owing if a taxpayer defaults on payment of taxes.
- A bond is generally a contract between the bonding company (surety) and the taxpayer that guarantees the payment of an unpaid excise tax liability to the government.
- In lieu of a corporate surety, a taxpayer may pledge and deposit for its bond, securities guaranteed by the United States.
- See 27 CFR Part 40, Subpart G and 27 CFR Part 44, Subpart F.

**26 U.S.C. 5711**

# Excise Tax Exemptions

- **Tobacco products furnished for employee use.** No limit for consumption on factory premises. For off-premise consumption, employees are limited each work day to 5 large cigars or cigarettes, 20 small cigars or cigarettes, or one retail package of smokeless tobacco. See 27 CFR 40.231.
- **Tobacco products furnished for experimental (including testing) purposes.** No limit on amount but exemption does not include use for purposes of advertising, consumer testing, or sampling.  
See 27 CFR 40.232.
- **Tobacco products removed to a transferee in bond or for export.** See 27 CFR 40.233 and Part 44.

# Excise Tax Exemptions (Continued)

**26 U.S.C. 5704**

- **Removal for use of the United States.** See 27 CFR Part 45.
- **Tobacco products released in bond from Customs custody to a tobacco products factory.** See 27 CFR 41.85.
- **Tobacco products exported and then returned.** May be transferred to the original manufacturer or an export warehouse proprietor authorized by the manufacturer. If the product will be marketed domestically, it must be repackaged without the export label and will be subject to tax upon removal. See 26 U.S.C. 5704(d), 5754.

# Claims for Credit or Refund of Tax

- Credit or refund is available on taxes paid for product withdrawn by the taxpayer from the market, on product lost (**otherwise than by theft**) or destroyed, by fire, casualty, or act of God, **while in the possession or ownership of the claimant**. See 26 U.S.C. 5705.
- For losses caused by disaster (as declared by the President), an amount equal to the taxes paid on the product may be paid to any person holding the product at the time of the disaster. Before claim is paid, TTB must verify that products have been destroyed. See 26 U.S.C. 5708.
- **Claim must be filed within 6 months** of loss or withdrawal.
- Claimant must show that it bore the ultimate burden of the tax. See 26 U.S.C. 6423; 27 C.F.R. 46.5 and 46.75.

# Drawback

- There shall be an allowance of drawback for tax paid on tobacco products and cigarette papers and tubes, when shipped to a foreign country, Puerto Rico, the Virgin Islands, or a possession of the United States.
- Claims must be made in accordance with the provisions at 27 CFR Part 44, Subpart K.

# Special Occupational Tax

- Every person engaged in the business as a manufacturer of tobacco products, manufacturer of cigarette papers and tubes, or as an export warehouse proprietor must pay a tax of \$1,000 per year for each premise at which such business is conducted.
- Reduced rate of \$500 for taxpayers with annual gross receipts less than \$500,000.
- Special tax stamp is issued by NRC as evidence of tax payment.
- A willful failure to pay the tax may result in a fine up to \$5,000 or in imprisonment up to two years, or both.

**26 U.S.C. 5731 – 5734**

# Tobacco Permits

- **Permit Required.** All tobacco product manufacturers, importers, and export warehouse proprietors are regulated by TTB and need a permit for lawful operations.
- **Processed Tobacco.** Although no excise tax is assessed on processed tobacco, manufacturers and importers of processed tobacco need to obtain permits and comply with applicable recordkeeping requirements to operate lawfully under new requirements imposed under CHIPRA.
- **Importer Permits.** Must be renewed every 3 years. See 27 CFR 41.201 and 41.202.

**26 U.S.C. 5712, 5713**

# Criteria for Denial of Permit Application

- **Adequate Premises.** Permit may be denied when the proposed premises would not adequately protect the revenue.
- **Minimum Activity Requirements.** Permit may be denied when the proposed activity would not meet minimum capacity or activity requirements established under the regulations.  
See 27 CFR 40.61 (applicant for manufacturer of tobacco product permit must intend to make tobacco products and not intend to merely receive and transfer them in bond).

# Criteria for Denial (continued)

Per Title VII of the Children's Health Insurance Program Reauthorization Act of 2009, Pub L. No 111-3, dated February 4, 2009 (CHIPRA), paragraph (3) of section 5712 of the IRC was amended to read: "Such person (including, in the case of a corporation, any officer, director, or principal stockholder and, in the case of a partnership, a partner) –

(A) is, by reason of his business experience, financial standing, or trade connections or by reason of previous or current legal proceedings involving a felony violation of any other provision of Federal criminal law relating to tobacco products, processed tobacco, cigarette paper, or cigarette tubes, not likely to maintain operations in compliance with [Chapter 52 of the IRC]

(B) has been convicted of a felony violation of any provision of Federal or State criminal law relating to tobacco products, processed tobacco, cigarette paper, or cigarette tubes, or

(C) has failed to disclose any material information required or made any material false statement in the application thereof."

# Permit Suspension or Revocation

As amended by CHIPRA, 26 U.S.C. 5713(b) provides that TTB may suspend or revoke a tobacco permit when it has reason to believe that any permittee –

(A) has not in good faith complied with [Chapter 52], or with any other provision of [the IRC] involving intent to defraud, or

(B) has violated the conditions of such permit, or

(C) has failed to disclose any material information required or made any false statement in the application for such permit, or

(D) has failed to maintain his premises in such manner as to protect the revenue, or

(E) is, by reason of previous or current legal proceedings involving a felony violation of any other provision of Federal criminal law relating to tobacco products, processed tobacco, cigarette paper, or cigarette tubes, not likely to maintain operations in compliance with [Chapter 52], or

(F) has been convicted of a felony violation of any provision of Federal or State criminal law relating to tobacco products, processed tobacco, cigarette paper, or cigarette tubes

# Inventory

- Make a true and accurate inventory at the time of commencing and concluding business and any other time as required by TTB regulations (now includes manufacturers and importers of processed tobacco)

See 27 CFR 40.201, 44.143-146

**26 U.S.C. 5721**

# Reports

- Every manufacturer or importer of processed tobacco, tobacco products, and cigarette papers and tubes, and every export warehouse proprietor must make such reports as required by TTB regulations

See 27 CFR 40.202, 40.422, 41.206, 44.147-151



**26 U.S.C. 5722**

# Packages, Marks, Labels, and Notices

**26 U.S.C. 5723**

## Package Requirements:

- Must be secure
- Must have name and location
- Must be affixed with a mark and notice
- Shall not contain lottery features
- Shall not contain indecent or immoral material

See 27 CFR 40.211-217; Part 41, Subpart E

# Recordkeeping

- Records enable TTB to track product from the time it is processed, manufactured or imported to the time it leaves regulated premises

See 27 CFR 40.181-187; 41.204-205; 44.142

# Imposition of Tax After Removal

- Liability may be imposed after removal on persons who, with intent to defraud, purchase, receive or possess tobacco products or cigarette papers and tubes:
  1. That have not been tax determined
  2. That have not been tax paid
  3. That have been diverted after removal without payment of tax
- Liability may also be imposed after removal on persons who purchase, receive or possess improperly packaged or labeled product

## New “Moonshine” Provision – Added by CHIPRA

- In the case of any tobacco products, cigarette paper, or cigarette tubes manufactured in the United States at any place other than the premises of a manufacturer of tobacco products, cigarette paper, or cigarette tubes that has filed the bond and obtained the permit required under this chapter, tax shall be due and payable immediately upon manufacture.
- On par with 26 U.S.C. 5006(c)(2) (distilled spirits), 5041(f) (wines) and 5054(a)(3) (beer)

**26 U.S.C. 5703(b)(2)(F)**

# Civil Penalties

- For each act in which an industry member neglects to comply with or otherwise acts contrary to any duty imposed by Chapter 52, TTB has authority to pursue a \$1000 penalty.
- A 5% underpayment penalty may be imposed.
- A penalty equal to \$1,000 or 5 times the amount of tax, whichever is greater, may be imposed on anyone who relands product labeled for exportation or who sells or receives such products or aids and abets in such selling, relanding or receiving. Forfeiture of property involved is provided.

## Civil Penalties (Continued)

- These penalties are additions to all other available penalty provisions under the IRC. See 26 U.S.C. 6651 (failure to pay/file), 6656 (failure to deposit), 6662 (accuracy-related penalty).

# Criminal Penalties

- Whoever, with intent to defraud:
  - Engages in business unlawfully
  - Fails to furnish information or who furnishes false information
  - Refuses to pay or who evades tax
  - Unlawfully removes tobacco products or cigarettes papers and tubes
  - Unlawfully purchases, receives, possesses, or sells tobacco products or cigarette papers and tubes
  - Destroys, obliterates, or detaches marks, labels, or notices before packages are emptied
- Shall, for each offense, be fined up to \$250,000 for individuals or \$500,000 for organizations, or be imprisoned for not more than 5 years, or both.  
See 18 U.S.C. 3571(enhanced fines)

# Forfeiture

## Property Subject to Forfeiture:

- Tobacco products and cigarette papers and tubes possessed with intent to defraud
- Tobacco products and cigarette papers and tubes that are not properly packaged
- Personal property of qualified manufacturers, importers, and export warehouse proprietors acting with intent to defraud
- Real and personal property of illicit operators.

# Extensive State and Federal Regulation



Collects Taxes on Imports



Warning Labels



Regulates Growers



Contraband Cigarette Trafficking & Jenkins Acts



NAAG – Master Settlement Agreement



Mail & Wire Fraud

# Contact Information

## **TTB National Revenue Center**

– **Phone:** (513) 684-3334

– **Mail:** 550 Main Street, Suite 8002,  
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