

**DESCRIPTION OF THE
REVENUE PROVISIONS FOR MARKUP OF THE STATE
CHILDREN'S HEALTH INSURANCE PROGRAM**

Scheduled for Markup
before the
SENATE COMMITTEE ON FINANCE
on July 17, 2007

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION



July 13, 2007
JCX-43-07

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup on July 17, 2007. This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the revenue provisions for markup of the State Children's Health Insurance Program.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of the Revenue Provisions for Markup of the State Children's Health Insurance Program* (JCX-43-07), July 13, 2007. This document can also be found on the web at www.house.gov/jct.

I. INCREASE TOBACCO TAX RATES AND MODIFY CERTAIN DEFINITIONS

A. Increase Excise Tax Rates on Tobacco Products and Cigarette Papers and Tubes

Present Law

Rates of excise tax on tobacco products and cigarette papers and tubes

Tobacco products and cigarette papers and tubes manufactured in the United States or imported into the United States are subject to Federal excise tax at the following rates:²

- Cigarettes weighing not more than three pounds per thousand (“small cigarettes”) are taxed at the rate of \$19.50 per thousand (\$0.39 per pack);
- Cigarettes weighing more than three pounds per thousand (“large cigarettes”) are taxed at the rate of \$40.95 per thousand, except that, if they measure more than six and one-half inches in length, they are taxed at the rate applicable to small cigarettes, counting each two and three-quarter inches (or fraction thereof) of the length of each as one cigarette;
- Cigars weighing not more than three pounds per thousand (“small cigars”) are taxed at the rate of \$1.828 per thousand;
- Cigars weighing more than three pounds per thousand (“large cigars”) are taxed at the rate equal to 20.719 percent of the manufacturer’s or importer’s sales price but not more than \$48.75 per thousand;
- Cigarette papers are taxed at the rate of \$0.0122 for each 50 papers or fractional part thereof, except that, if they measure more than six and one-half inches in length, they are taxable by counting each two and three-quarter inches (or fraction thereof) of the length of each as one cigarette paper;
- Cigarette tubes are taxed at the rate of \$0.0244 for each 50 tubes or fractional part thereof, except that, if they measure more than six and one-half inches in length, they are taxable by counting each two and three-quarter inches (or fraction thereof) of the length of each as one cigarette tube;
- Snuff is taxed at the rate of \$0.585 per pound, and proportionately at that rate on all fractional parts of a pound;
- Chewing tobacco is taxed at the rate of \$0.195 per pound, and proportionately at that rate on all fractional parts of a pound;

² Sec. 5701. Except where otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended (the “Code”).

- Pipe tobacco is taxed at the rate of \$1.0969 per pound, and proportionately at that rate on all fractional parts of a pound; and
- Roll-your-own tobacco is taxed at the rate of \$1.0969 per pound, and proportionately at that rate on all fractional parts of a pound.

Floor stocks tax and foreign trade zones

Special tax and duty rules apply with respect to foreign trade zones. In general, merchandise may be brought into a foreign trade zone without being subject to the general customs laws of the United States. Such merchandise may be stored in a foreign trade zone or may be subjected to manufacturing or other processes there. The United States Customs and Border Protection agency of the Department of Homeland Security (“Customs”) may determine internal revenue taxes and liquidate duties imposed on foreign merchandise in such foreign trade zones. Articles on which such taxes and applicable duties have already been paid, or which have been admitted into the United States free of tax, that have been taken into a foreign trade zone from inside the United States, may be held under the supervision of a customs officer. Such articles may later be released back into the United States free of further taxes and duties.³

Description of Proposal

Rate increases

Under the proposal, the rates of excise tax on tobacco products and cigarette papers and tubes are increased, generally in a proportionate manner. The special rules under present law relating to large cigarettes and cigarette papers and tubes longer than six and one-half inches remain the same. The rates under the proposal are as follows:

- Small cigarettes are taxed at the rate of \$50.00 per thousand (\$1.00 per pack);
- Large cigarettes are taxed at the rate of \$104.9999 per thousand;
- Small cigars are taxed at the rate of \$50.00 per thousand (the same rate applied to small cigarettes);
- Large cigars are taxed at the rate equal to 53.13 percent of the manufacturer’s or importer’s sales price but not more than \$10.00 per cigar;
- Cigarette papers are taxed at the rate of \$0.0313 for each 50 papers or fractional part thereof;
- Cigarette tubes are taxed at the rate of \$0.0626 for each 50 tubes or fractional part thereof;

³ 19 U.S.C. sec. 81c(a).

- Snuff is taxed at the rate of \$1.50 per pound, and proportionately at that rate on all fractional parts of a pound;
- Chewing tobacco is taxed at the rate of \$0.50 per pound, and proportionately at that rate on all fractional parts of a pound;
- Pipe tobacco is taxed at the rate of \$2.8126 per pound, and proportionately at that rate on all fractional parts of a pound; and
- Roll-your-own tobacco is taxed at the rate of \$8.9286 per pound, and proportionately at that rate on all fractional parts of a pound. The rate for roll-your-own tobacco is intended to approximate the rate for small cigarettes.

Floor stocks tax and foreign trade zone treatment

The proposal also imposes a tax on floor stocks. Taxable articles (i.e., those articles listed above) manufactured in the United States or imported into the United States which are removed before January 1, 2008 and held on that date for sale by any person are subject to a floor stocks tax. The floor stocks tax is equal to the excess of the applicable tax under the new rates over the applicable tax at the present-law rates. The person holding the article on January 1, 2008 to which the floor stocks tax applies is liable for the tax. Each such person is allowed a \$500 credit against the floor stocks tax.

Notwithstanding any other provision of law, the floor stocks tax applies to an article located in a foreign trade zone on January 1, 2008, provided that internal revenue taxes have been determined, or customs duties have been liquidated, with respect to such article before such date, or such article is held on a tax-and-duty-paid basis on such date under the supervision of a customs officer.

For purposes of determining the floor stocks tax, component members of a “controlled group” (as modified) are treated as one taxpayer.⁴ “Controlled group” for these purposes means a parent-subsidiary, brother-sister, or combined corporate group with more than 50-percent ownership with respect to either combined voting power or total value. Under regulations, similar principles may apply to a group of persons under common control where one or more persons are not a corporation.

The proposal provides that the floor stocks tax shall be paid on or before April 1, 2008, in the manner prescribed by Treasury regulations. In general, all of the rules, including penalties, applicable with respect to taxes on tobacco products and cigarette papers and tubes apply to the floor stocks tax. The person who bore the ultimate burden of the floor stocks tax may be treated as the person entitled to a credit of refund of such tax.

⁴ Controlled group is defined in section 1563.

Effective Date

The proposal applies to articles removed after December 31, 2007.

B. Modify Definition of Roll-Your-Own Tobacco

Present Law

Federal excise taxes are imposed upon tobacco products and cigarette papers and tubes.⁵ Tobacco products are cigars, cigarettes, snuff, chewing tobacco, pipe tobacco, and roll-your-own tobacco. A “cigar” is any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco, other than any roll of tobacco which is a cigarette. A “cigarette” is (i) any roll of tobacco wrapped in paper or in any substance not containing tobacco; and (ii) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette. “Roll-your-own tobacco” is any tobacco, which because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes. “Cigarette paper” is paper, or any other material except tobacco, prepared for use as a cigarette wrapper. A “cigarette tube” is cigarette paper made into a hollow cylinder for use in making cigarettes.⁶

Wrappers containing tobacco are not within the definition of cigarette papers or tubes because they contain tobacco. They are also not generally within the definition of roll-your-own tobacco because they are usually used to make cigars, not cigarettes. For the same reason, loose tobacco suitable for making roll-your-own cigars is not considered to be roll-your-own tobacco.

Description of Proposal

Under the proposal, roll-your-own tobacco also includes any tobacco, which because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigars, or for use as wrappers for making cigars.

Effective Date

The proposal applies to articles removed after December 31, 2007.

⁵ Sec. 5701.

⁶ Sec. 5702.

II. STRENGTHEN REGULATORY AND ENFORCEMENT AUTHORITY WITH RESPECT TO TOBACCO AND ALCOHOL

A. Clarify Statute of Limitations Pertaining to Excise Taxes Imposed on Imported Alcohol, Tobacco Products and Cigarette Papers and Tubes

Present Law

Under the Code, amounts of tax must generally be assessed within three years after a tax return is filed, and no proceeding in court without assessment for the collection of such tax may begin after such period has expired.⁷ If no return is filed (but is required), the tax may be assessed, or a proceeding in court for the collection of such tax may be initiated without assessment, at any time.⁸

Customs collects duties and excise taxes on imports. Importers of taxable articles relating to tobacco and alcohol must file a tax return with Customs.⁹ In general, the limitations period for fixing and assessing duties and taxes with respect to an import is one year from the date of entry or removal.¹⁰ Under the applicable customs law, with some limited exceptions, any duty or tax imposed on an import is final and conclusive upon all persons, including the United States, unless a protest is filed within 180 days or a court action is timely commenced.¹¹

Description of Proposal

The proposal clarifies the tax and customs law in the area of alcohol and tobacco products by providing that, notwithstanding customs law, the general statute of limitations for assessment under the Code (sec. 6501) applies with respect to taxes imposed under chapters 51 (relating to distilled spirits, wines, and beer) and 52 (relating to tobacco products and cigarette papers and tubes) of the Code.

No inference is intended regarding the applicability of the statute of limitations under the Code to pending cases or to excise taxes imposed other than under chapters 51 and 52 of the Code.

⁷ Sec. 6501(a).

⁸ Sec. 6501(c)(3).

⁹ 24 C.F.R. sec. 41.81(b) (tobacco products and cigarette papers and tubes); sec. 5061(a) (distilled spirits, wines, and beer).

¹⁰ 19 U.S.C. sec. 1504(a). The Secretary may extend this period under certain circumstances and with notice to the importer.

¹¹ 19 U.S.C. sec. 1514(a) & (c)(3).

Effective Date

The proposal is effective for articles imported into the United States after the date of enactment.

B. Impose Immediate Tax on Unlawfully Manufactured Tobacco Products and Cigarette Papers and Tubes

Present Law

Manufacturers and importers of tobacco products and proprietors of export warehouses must obtain a permit to engage in such businesses.¹² A permit is obtained by application to the Secretary of the Treasury or his delegate (“Secretary”).¹³ A manufacturer of tobacco products or cigarette papers or tubes, or an export warehouse proprietor, must file a bond and obtain approval of such bond from the Secretary.¹⁴ In general, excise taxes on tobacco products and cigarette papers and tubes manufactured in the United States are determined at the time of removal. In the case of taxes on tobacco products and cigarette papers and tubes removed during any semimonthly period under bond for deferred payment of tax, payment is due no later than the 14th day after the last day of such semimonthly period.¹⁵

Distilled spirits, wines, and beer produced at any place other than a place required by the Code are subject to tax immediately on production.¹⁶ There is no rule that imposes immediate tax on tobacco products and cigarette papers and tubes that are produced by an out-of-compliance manufacturer.

Description of Proposal

Under the proposal, in the case of any tobacco products or cigarette papers or tubes produced in the United States at any place other than the premises of a manufacturer that has obtained a permit (if required) and approval of a bond, the excise tax is due and payable immediately upon manufacture, unless they are produced solely for the person’s own personal consumption or use.

Effective Date

The proposal is effective on the date of enactment.

¹² Sec. 5713. A “manufacturer of tobacco products” does not include (1) a person who produces tobacco products solely for the person’s own personal consumption or use, and (2) a proprietor of a customs bonded manufacturing warehouse with respect to the operation of such warehouse. Sec. 5702(d).

¹³ Sec. 5712.

¹⁴ Sec. 5711.

¹⁵ Sec. 5703.

¹⁶ Sec. 5006(c)(2) (distilled spirits); sec. 5041(f) (wines); sec. 5054(a)(3) (beer).

C. Permit, Reporting, and Recordkeeping Requirements for Manufacturers and Importers of Processed Tobacco

Present Law

Tobacco products and cigarette papers and tubes are subject to Federal excise tax.¹⁷ Tobacco products are cigars, cigarettes, smokeless tobacco, pipe tobacco, and roll-your-own tobacco.¹⁸ Manufacturers and importers of tobacco products and export warehouse proprietors must obtain a permit from the Secretary of the Treasury or his delegate (“Secretary”).¹⁹ Manufacturers and importers of tobacco products or cigarette papers or tubes, and export warehouse proprietors, must also periodically make an inventory and certain reports and keep certain records, all as prescribed by the Secretary.²⁰

Description of Proposal

The proposal creates a new category of manufacturers and importers who are subject to regulation but not to Federal excise tax. Under the proposal, manufacturers and importers of “processed tobacco” are subject to the present-law permit, inventory, reporting, and recordkeeping requirements. Processed tobacco is any tobacco other than tobacco products. A manufacturer of processed tobacco is any person who processes any tobacco other than tobacco products, and an importer includes an importer of processed tobacco. However, the processing of tobacco does not include the farming or growing of tobacco or the handling of whole tobacco leaf solely for sale, shipment, or delivery to a manufacturer of tobacco products or processed tobacco. For example, under the proposal an importer of “cut rag” tobacco or a leaf processor that manufactures such tobacco is subject to the general permit, inventory, reporting, and recordkeeping requirements of the Code but is not subject to Federal excise tax (unless it also imports or manufactures tobacco products or cigarette papers or tubes).

Effective Date

The proposal is effective on January 1, 2008.

¹⁷ Sec. 5701.

¹⁸ Sec. 5702.

¹⁹ Sec. 5713.

²⁰ Sec. 5721 (inventories); sec. 5722 (reports); sec. 5741 (records).

D. Broaden Authority to Deny, Suspend, and Revoke Tobacco Permits

Present Law

Manufacturers and importers of tobacco products and proprietors of export warehouses must obtain a permit to engage in such businesses.²¹ A permit is obtained by application to the Secretary. The Secretary may deny the application if (1) the business premises are inadequate to protect the revenue; (2) the activity to be carried out at the business premises does not meet such minimum capacity or activity requirements as prescribed by the Secretary; (3) the applicant is, by reason of his business experience, financial standing, or trade connections, not likely to maintain operations in compliance with the applicable provisions of the Code; or (4) such applicant has failed to disclose any material information required or made any material false statement in the application.²²

A permit is conditioned upon compliance with the rules of the Code and related regulations pertaining to taxes and regulation of tobacco products and cigarette papers and tubes. The Secretary may suspend or revoke a permit after a notice and hearing if the holder (1) has not in good faith complied with those rules; (2) has violated any other provision of the Code involving intent to defraud; (3) has violated the conditions of the permit; (4) has failed to disclose any material information required or made any material false statement in the permit application; or (5) has failed to maintain the business premises in such a manner as to protect the revenue.²³

Description of Proposal

Under the proposal, the Secretary may deny an application for a permit if the applicant has been convicted of a felony violation of a Federal or State criminal law relating to tobacco products or cigarette papers or tubes, or if, by reason of previous or current legal proceedings involving a violation of Federal criminal felony laws relating to tobacco products or cigarette papers or tubes, such applicant is not likely to maintain operations in compliance with the applicable provisions of the Code.

Similarly, a permit may be suspended or revoked if the holder is convicted of a felony violation of a Federal or State criminal law relating to tobacco products or cigarette papers or tubes, or if, by reason of previous or current legal proceedings involving a violation of Federal criminal felony laws relating to tobacco products or cigarette papers or tubes, such applicant is not likely to maintain operations in compliance with the applicable provisions of the Code.

²¹ Sec. 5713.

²² Sec. 5712.

²³ Sec. 5713.

Effective Date

The proposal is effective on the date of enactment.

III. MISCELLANEOUS PROPOSALS

A. Modifications to Corporate Estimated Tax Payments

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability. For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15.

Under present law, in the case of a corporation with assets of at least \$1 billion, the payments due in July, August, and September, 2012, shall be increased to 114.50 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Description of Proposal

The proposal reduces the percentage from 114.50 percent to 113.25 percent.

Effective Date

The proposal is effective on the date of enactment.