

**PRESENT LAW AND BACKGROUND RELATING  
TO TOBACCO EXCISE TAXES**

Scheduled for a Public Hearing  
Before the  
SENATE COMMITTEE ON FINANCE  
Scheduled for July 29, 2014

Prepared by the Staff  
of the  
JOINT COMMITTEE ON TAXATION



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## INTRODUCTION AND SUMMARY

The Senate Committee on Finance has scheduled a public hearing on July 29, 2014, titled “Tobacco: Taxes Owed, Avoided, and Evaded.” This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, includes a description of present law and background relating to excise taxes on tobacco.

The enactment of The Children’s Health Insurance Program Reauthorization Act of 2009 (“CHIPRA”),<sup>2</sup> increased the Federal excise taxes on tobacco products<sup>3</sup> and cigarette papers and tubes. As a result of these changes in tobacco rates manufacturers and retailers have an incentive to change the way they manufacture, label, promote, and market certain tobacco products. For example, manufactures may re-label traditional roll-your-own tobacco brands as pipe tobacco or add weight to inexpensive small cigars in order to classify them as large cigars, retail establishments might offer cigarette-rolling machines as an alternative to traditional packs of cigarettes, and manufactures or importers of large cigars have an incentive to find ways to lower the sale price.

Federal excise taxes are imposed on tobacco products and cigarette papers and tubes that are manufactured or imported into the United States. The Internal Revenue Code and regulations provide rules for determining the price to be used as the basis for taxing large cigars (the “tax price”). Manufacturers and importers are required to obtain permits before commencing business and are subject to certain reporting, record keeping, and labeling requirements and occupational taxes. Part I discusses the relevant present law.

With the enactment of CHIPRA, the tax rate on a pack of cigarettes increased from 39 cents to \$1.0066 per pack and the tax rates on small cigars and roll-your-own tobacco rose to equivalence with the tax rate on cigarettes. Taxes on other tobacco products and cigarette papers and tubes were also increased. The Moving Ahead for Progress in the 21<sup>st</sup> Century Act (“MAP-21”)<sup>4</sup> clarified that the definition of tobacco manufacturer under the Internal Revenue Code included any businesses (including retailers) providing roll-your-own cigarette machines to their customers. These legislative changes are discussed in more detail in Part II.

With the exception of collection of taxes on imported products, these excise taxes are administered and enforced by the Alcohol and Tobacco Tax and Trade Bureau (“TTB”) of the Department of the Treasury.<sup>5</sup> The authority to collect taxes on imported tobacco products and

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Present Law and Background Relating to Tobacco Excise Taxes* (JCX-93-14), July 25, 2014. This document can be found on our website at [www.jct.gov](http://www.jct.gov). Except where otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended.

<sup>2</sup> Pub. L. No. 111-3, Feb. 4, 2009.

<sup>3</sup> The term “tobacco products” means cigars, cigarettes, smokeless tobacco (snuff and chewing tobacco), pipe tobacco, and roll-your-own tobacco. Secs. 5702(c) and 5702(m).

<sup>4</sup> Pub. L. No. 112-141, July 6, 2012.

<sup>5</sup> See the Homeland Security Act of 2002, Pub. L. No. 107-296, sec. 1111 (Nov. 25, 2002); and Treasury Order 120-01 (Revised), par. 2, 68 F.R. 3583 (Jan. 24, 2003).

cigarette papers and tubes is delegated to the U.S. Customs and Border Protection agency of the Department of Homeland Security (“CBP”) by the Secretary of the Treasury.<sup>6</sup> TTB has issued guidance related to the regulation of tobacco products, cigarette papers and tubes, and processed tobacco. Part III discusses the role of TTB in the collection and administration of excise taxes on tobacco.

The Family Smoking Prevention and Tobacco Control Act (the “Tobacco Control Act”)<sup>7</sup> gives the U.S. Food and Drug Administration (“FDA”) the authority to regulate the manufacture, distribution, and marketing of tobacco products. Part IV discusses some of the provisions of the Tobacco Control Act and some recent actions by the FDA related to the regulation of tobacco.

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<sup>6</sup> See 6 U.S.C. sec. 215(1) and 27 CFR sec. 41.62.

<sup>7</sup> Pub. L. No. 111-31, June 22, 2009.

## I. PRESENT LAW

### A. Excise Taxes on Tobacco Products and Cigarette Papers and Tubes

Excise taxes are imposed on tobacco products and cigarette papers and tubes that are manufactured or imported into the United States.<sup>8</sup> The tax liability comes into existence when the domestic tobacco products are manufactured and is determined and payable when the tobacco products or cigarette papers and tubes are removed in packages from the bonded premises of the manufacturer. These excise taxes are administered and enforced by the Secretary of the Treasury through the TTB, with the exception of the taxes on imported tobacco products and cigarette papers and tubes. Authority to collect those taxes is delegated to CBP, except where such imported products are transferred in bond to the bonded premises of a manufacturer of tobacco products or cigarette papers and tubes or export warehouse proprietor.

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:<sup>9</sup>

- Cigars weighing not more than three pounds per thousand (“small cigars”) are taxed at the rate of \$50.33 per thousand;
- Cigars weighing more than three pounds per thousand (“large cigars”) are taxed at the rate equal to 52.75 percent of the manufacturer’s or importer’s sales price but not more than 40.26 cents per cigar;
- Cigarettes weighing not more than three pounds per thousand (“small cigarettes”) are taxed at the rate of \$50.33 per thousand (\$1.0066 per pack);
- Cigarettes weighing more than three pounds per thousand (“large cigarettes”) are taxed at the rate of \$105.69 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;
- Cigarette papers are taxed at the rate of 3.15 cents 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 6.30 cents 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;

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<sup>8</sup> Sec. 5701.

<sup>9</sup> *Ibid.*

- Snuff is taxed at the rate of \$1.51 per pound, and proportionately at that rate on all fractional parts of a pound;
- Chewing tobacco is taxed at the rate of 50.33 cents per pound, and proportionately at that rate on all fractional parts of a pound;
- Pipe tobacco is taxed at the rate of \$2.8311 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 \$24.78 per pound, and proportionately at that rate on all fractional parts of a pound.

Tobacco products and cigarette papers and tubes may be exported from the United States without payment of tax. Special tax and duty rules apply with respect to foreign trade zones. Foreign trade zones are areas within U.S. territory that are licensed to permit domestic activity with respect to foreign items without the necessity of formal entry to the United States. Such zones are intended to facilitate international trade.<sup>10</sup> 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. CBP 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 CBP officer. Such articles may later be released back into the United States free of further taxes and duties.<sup>11</sup>

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<sup>10</sup> Foreign trade zones are licensed by the U.S. Foreign-Trade Zones Board, chaired by the Secretary of Commerce, and under the supervision of the CBP. See 19 U.S.C. secs. 81a-81u and 15 C.F.R. Part 400.

<sup>11</sup> 19 U.S.C. sec. 81c(a).

## B. Definitions Applicable to Tobacco Excise Taxes

Several definitions applicable to tobacco excise taxes are included in the Internal Revenue Code. The definitions of tobacco products determine the tax rate that will apply as well as the licensing and record keeping requirements that may apply to a manufacturer or importer of the products. Other definitions determine the time the tax liability arises or the timing of its payment.

The term “cigarette” is defined as (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; and (2) 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 described in (1).<sup>12</sup> A “small cigarette” is any cigarette weighing not more than three pounds per thousand and a “large cigarette” is any cigarette weighing more than three pounds per thousand.<sup>13</sup>

The term “cigar” is defined as any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco other than any roll of tobacco which is a cigarette as defined above.<sup>14</sup> A “small cigar” is any cigar weighing not more than three pounds per thousand and a “large cigar” is any cigar weighing more than three pounds per thousand.<sup>15</sup>

The term “roll-your-own tobacco” is defined as 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 or cigars, or for use as wrappers.<sup>16</sup>

The term “pipe tobacco” is defined as 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 to be smoked in a pipe.<sup>17</sup>

The term “cigarette paper” is defined as paper, or any other material except tobacco, prepared for use as a cigarette wrapper.<sup>18</sup>

A “cigarette tube” is defined as cigarette paper made into a hollow cylinder for use in making cigarettes.<sup>19</sup>

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<sup>12</sup> Sec. 5702(b).

<sup>13</sup> See secs. 5701(b)(1) and (b)(2). The definitions of small and large cigarette are not part of the cigarette definition in section 5702(b), instead, they are found in section 5701(b) with the applicable tax rates.

<sup>14</sup> Sec. 5702(a).

<sup>15</sup> See secs. 5701(a)(1) and (a)(2). As with cigarettes, the definitions of small and large cigars are not part of the cigar definition in section 5702(a), instead, they are found in sec 5701(a) with the applicable tax rates.

<sup>16</sup> Sec. 5702(o).

<sup>17</sup> Sec. 5702(n).

<sup>18</sup> Sec. 5702(e).

“Smokeless tobacco” means any snuff or chewing tobacco.<sup>20</sup> The term “snuff” means any finely cut, ground, or powdered tobacco that is not intended to be smoked. The term “chewing tobacco” means any leaf tobacco that is not intended to be smoked.

The term “removal” or “remove” means the removal of tobacco products or cigarette papers and tubes, or any processed tobacco, from the factory or from internal revenue bond, or release from customs custody, and includes smuggling or other unlawful importation of these products into the United States.<sup>21</sup>

A “manufacturer of tobacco products” is any person who manufactures cigars, cigarettes, smokeless tobacco, pipe tobacco, or roll-your-own tobacco.<sup>22</sup> A person who produces tobacco products solely for the person’s own personal consumption or use is not a manufacturer of tobacco products. There is also an exception for a proprietor of a customs bonded manufacturing warehouse with respect to the operation of the warehouse. The term “manufacturer of tobacco products” includes any person who for commercial purposes makes available for consumer use (including a consumer’s personal use) a machine capable of making cigarettes, cigars, or other tobacco products. A person making such a machine available for consumer use is deemed the person making the removal with respect to any tobacco products manufactured by the machine. This provision does not apply to a person who sells a machine directly to a consumer at retail for a consumer’s personal home use if the machine is not used at a retail premises and is designed to produce tobacco products only in personal use quantities.

A “manufacturer of processed tobacco” is any person who processes any tobacco other than cigars, cigarettes, smokeless tobacco, pipe tobacco or roll-your-own tobacco.<sup>23</sup> The processing of tobacco does not include farming or growing tobacco or handling tobacco solely for sale, shipment, or delivery to a manufacturer of tobacco products or processed tobacco. Manufacturers and importers of processed tobacco are subject to regulation, but no Federal excise tax is imposed on processed tobacco.

An “importer” is any person in the United States (1) to whom nontaxpaid tobacco products or cigarette papers or tubes, or processed tobacco, manufactured in a foreign country, Puerto Rico, the Virgin Islands, or a U.S. possession are shipped or consigned; (2) who removes cigars or cigarettes for sale or consumption in the United States from a customs bonded manufacturing warehouse; or (3) who smuggles or otherwise unlawfully brings tobacco products or cigarette papers or tubes into the United States.<sup>24</sup>

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<sup>19</sup> Sec. 5702(f).

<sup>20</sup> Sec. 5702(m).

<sup>21</sup> Sec. 5702(j).

<sup>22</sup> Sec. 5702(d).

<sup>23</sup> Sec. 5702(p).

<sup>24</sup> Sec. 5702(k).

### C. Large Cigars and Excise Tax *Ad Valorem* Pricing Rules

The Internal Revenue Code and TTB regulations provide rules for determining the tax price on large cigars.<sup>25</sup> In determining the tax price of a large cigar, any cost incident to placing the cigar in condition ready for use is included. The Federal excise tax and any retail sales tax (if stated as a separate charge) imposed by any State or political subdivision or the District of Columbia is excluded from the tax price. Constructive sale price rules similar to the rules applicable to other manufacturer excise taxes found in section 4216(b) apply. The tax is computed based on the sale price for which the large cigars are sold by the manufacturer or importer. In addition to money, the sale price includes any goods or services exchanged for cigars.

The constructive sales price rules apply when a taxable article is sold by the manufacturer, or importer at retail, on consignment, or sold (other than through an arm's-length transaction) for less than the fair market price. The tax is computed on the price for which the articles are sold, in the ordinary course of trade, by manufacturers or importers, as determined by TTB.<sup>26</sup>

Section 4216(b) provides that in the case of an article sold at retail, the price for tax purposes is the lower of (1) the price for which the article is sold, or (2) the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers or producers, as determined by the Secretary; however, these rules do not apply if the special rule applies. The special rule for a retail sale or a sale directly to a retailer applies if the manufacturer, producer, or importer, in an arm's-length transaction (1) regularly sells such articles at retail or to retailers, and (2) regularly sells such articles to one or more wholesale distributors in arm's-length transactions (and the price is determined without regard to any tax benefit). In such case the price of the article for tax purposes is the lower of (1) the price for which the article is sold, or (2) the highest price for which the articles are sold by the manufacturer, producer, or importer to wholesale distributors.

Other constructive sale price rules apply where a manufacturer, producer, or importer sells articles to a related-party distributor. If the manufacturer, producer, or importer regularly sells such articles to related-party distributors and the related-party distributor regularly sells such articles to independent retailers, but not wholesale distributors, the tax price is 90 percent of the lowest price for which such distributor regularly sells in arm's-length transactions to independent retailers. For purposes of these rules, the lowest price is determined without regard to quantity discounts, and any fixed amount to which the purchaser has a right as a result of any contractual arrangement at the time of sale.

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<sup>25</sup> See sec. 5702(l) and sec. 27 CFR sec. 40.22.

<sup>26</sup> See sec. 4216(b).

## D. Requirements for Manufacturers and Importers

Manufacturers and importers of tobacco products or cigarette papers or tubes, processed tobacco, and export warehouse proprietors, must obtain a permit before commencing business as a manufacturer or importer of these products. Additionally these manufactures and importers are required to make an inventory,<sup>27</sup> prepare certain reports,<sup>28</sup> and keep certain records,<sup>29</sup> all as prescribed by the Secretary. Manufacturers and importers of taxable products and export warehouse proprietors may also be required to file a bond.<sup>30</sup> The Internal Revenue Code also contains certain labeling requirements, imposition of occupational taxes and various fines and penalties for noncompliance with the laws.

### Permit

Manufacturers and importers of tobacco products, processed tobacco, and proprietors of export warehouses must obtain a permit to engage in such businesses.<sup>31</sup> 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, or by reason of previous or current legal proceedings involving a felony violation of another provision of Federal criminal law relating to tobacco products, processed tobacco, cigarette paper or cigarette tubes, not likely to maintain operations in compliance with the applicable provisions of the Internal Revenue Code; (4) the applicant 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 (5) such applicant has failed to disclose any material information required or made any material false statement in the application.<sup>32</sup> In the case of a corporation, an applicant includes any officer, director, or principal stockholder and, in the case of a partnership, a partner.

A permit is conditioned upon compliance with the rules of the Internal Revenue Code and related regulations pertaining to taxes and regulation of tobacco products, processed tobacco, 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 or has violated any other provision of the Internal Revenue Code involving intent to defraud; (2) has violated the conditions of the permit; (3) has failed to disclose any material information required or made any material false statement in the permit application; (4) has failed to maintain the business premises in such a manner as to protect the revenue; (5) is, by reason of previous or current legal

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<sup>27</sup> Sec. 5721.

<sup>28</sup> Sec. 5722.

<sup>29</sup> Sec. 5741.

<sup>30</sup> Sec. 5711.

<sup>31</sup> Sec. 5713(a).

<sup>32</sup> Sec. 5712.

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 this chapter; or (6) 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.<sup>33</sup>

### **Packaging and labels**

All tobacco products, processed tobacco, and cigarette papers and tubes must be packaged and labeled as required by the secretary.<sup>34</sup> Indecent or immoral pictures, prints, or representations are not permitted on packaging or labels. There is an exception to the packaging and labeling requirements for products furnished to employees for personal use or consumption, for experimental purposes, and for product transferred to the bonded warehouse of another manufacturer.

### **Occupational tax**

An occupational tax of \$1,000 per year is imposed on manufacturers of tobacco products, cigarette papers and tubes, and export warehouse proprietors.<sup>35</sup> A reduced rate of \$500 per year applies to taxpayers with excise tax liability in the prior year of less than \$500,000.<sup>36</sup> Controlled groups are treated as a single person. Any person engaged in business subject to the occupational tax who willfully fails to pay the tax imposed is subject to a fine of not more than \$5,000 or imprisonment of not more than two years, or both, for each such offense.

### **Fines and penalties**

The Internal Revenue Code contains various provisions related to the purchase, receipt, possession, sale, or disposal of certain tobacco products and cigarette papers and tubes as well as imposes restrictions on importation of previously exported tobacco products. Civil and criminal penalties and forfeiture provisions apply for failure to comply with the tobacco provisions.

Civil penalties apply to certain actions including the willful failure to comply with the duties imposed (such as record keeping and labeling), failure to pay tax, and for the illegal sale of tobacco products.<sup>37</sup> Criminal penalties apply to certain actions including engaging in business unlawfully, failing to furnish certain information or furnishing false or fraudulent information, tax evasion, unlawful removal of tobacco products or cigarette papers or tubes, and for purchasing, receiving, possessing, or selling tobacco products or cigarette papers or tubes unlawfully.<sup>38</sup> Tobacco products and cigarette papers and tubes are subject to forfeiture if they

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<sup>33</sup> Sec. 5713(b).

<sup>34</sup> Sec. 5723.

<sup>35</sup> Sec. 5731(a).

<sup>36</sup> Sec. 5731(b).

<sup>37</sup> Sec. 5761.

<sup>38</sup> Sec. 5762.

are possessed with the intent to defraud the United States, or are not in packaging as required under the law.<sup>39</sup> Additional property may also be subject to forfeiture if it is used to engage in the manufacturing business unlawfully, or if the proprietor makes false or fraudulent records or reports with the intent to defraud the United States.

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<sup>39</sup> Sec. 5763.

## II. SELECTED LEGISLATIVE HISTORY

### A. The Children’s Health Insurance Program Reauthorization Act of 2009

Prior to the enactment of CHIPRA, the tax applicable to small cigars was substantially below the excise tax on small cigarettes and generally lower than the tax on large cigars; the tax rates applicable to roll-your-own tobacco and pipe tobacco were the same. CHIPRA increased the rates on tobacco products as described in the table below. Notably, the tax rate on small cigars increased to the tax rate imposed on small cigarettes and the tax rate on roll-your-own tobacco increased above the tax rate on pipe tobacco. These changes are discussed in more detail below.

The following table lists the pre- and post-CHIPRA rates of tax on tobacco products and cigarette papers and tubes.

Tobacco Product	Pre-CHIPRA Tax Rates	Present Law Tax Rates
“Small cigarettes” (weighing three pounds or less per thousand)	\$19.50 per thousand <sup>40</sup>	\$50.33 per thousand <sup>41</sup>
“Large cigarettes” (weighing more than three pounds per thousand) <sup>42</sup>	\$40.95 per thousand	\$105.69 per thousand
“Small cigars” (weighing three pounds or less per thousand)	\$1.828 per thousand	\$50.33 per thousand
“Large cigars” (weighing more than three pounds per thousand)	20.719 percent of manufacturer’s sales price, but not more than \$48.75 per thousand	52.75 percent of manufacturer’s sales price, but not more than 40.26 cents per cigar
Snuff	58.5 cents per pound <sup>43</sup>	\$1.51 per pound
Chewing tobacco	19.5 cents per pound	50.33 cents per pound
Pipe tobacco	\$1.0969 per pound	\$2.8311 per pound
“Roll-your-own” tobacco	\$1.0969 per pound	\$24.78 per pound

<sup>40</sup> The tax rate equals \$0.39 per pack of 20 cigarettes.

<sup>41</sup> The tax rate equals \$1.0066 per pack of 20 cigarettes.

<sup>42</sup> Large cigarettes more than 6.5 inches long are taxed as small cigarettes, counting each 2.75 inches in length (or fraction thereof) as one cigarette. Sec. 5701(b)(2).

<sup>43</sup> The tax rate on snuff, chewing tobacco, pipe tobacco and roll-your-own tobacco is applied proportionately to fractional parts of a pound.

<b>Tobacco Product</b>	<b>Pre-CHIPRA Tax Rates</b>	<b>Present Law Tax Rates</b>
Cigarette papers <sup>44</sup>	1.22 cents for each 50 papers <sup>45</sup>	3.15 cents for each 50 papers
Cigarette tubes	2.44 cents for each 50 tubes <sup>46</sup>	6.30 cents for each 50 tubes

### **Small and large cigars**

Prior to CHIPRA, small cigars were taxed advantageously compared to both cigarettes and all but the most inexpensive large cigars. Small cigars were taxed at the rate of \$1.828 per thousand cigars (about four cents per pack of twenty, or 2/10<sup>th</sup>s of a cent per cigar); large cigars were taxed at the rate of 20.719 percent of the manufacturer's or importer's sales price but not more than \$48.75 per thousand cigars (about five cents per cigar); and small cigarettes were taxed at the rate of \$19.50 per thousand (about 39 cents per pack of twenty or two cents per cigarette). Thus, pre-CHIPRA, small cigars were taxed at a substantially lower rate than cigarettes and were taxed at a lower rate than large cigars with a manufacturer's or importer's sales price of more than 0.88 cents per cigar.<sup>47</sup>

After CHIPRA, inexpensive large cigars face a lower tax than either cigarettes or small cigars. Under present law, both small cigars and cigarettes are taxed at the rate of \$50.33 per thousand (\$1.0066 per pack, or just more than five cents per cigar or cigarette) while large cigars are taxed at the rate of 52.75 percent of the manufacturer's or importer's sales price but not more than 40.26 cents per cigar. Thus, small cigars are taxed equivalently to cigarettes and at a higher rate than large cigars with a manufacturer's or importer's sales price of less than 9.5 cents per cigar.<sup>48</sup> There is a maximum tax for large cigars of 40.26 cents, but no minimum tax. The absence of a minimum tax provides an incentive to manufacturers of small cigars to increase the weight of the cigars to more than three pounds per thousand such that the cigars may be classified, and taxed at lower rates, as large cigars.

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<sup>44</sup> Cigarette papers and tubes measuring more than 6.5 inches in length are taxed at the rate prescribed, counting each 2.75 inches (or fraction thereof) as one cigarette paper.

<sup>45</sup> This tax rate also applies to fractional parts thereof, both pre-CHIPRA and at current rates.

<sup>46</sup> This tax rate also applies to fractional parts thereof, both pre-CHIPRA and at current rates.

<sup>47</sup> The tax per small cigar pre-CHIPRA was 0.1828 cents. This rate equals the tax paid on a large cigar with a taxable price of 0.8823 cents (20.719 percent of 0.8823 cents is 0.1828 cents). Large cigars with a taxable price of more than 0.8823 cents are subject to a higher tax than the tax applicable to small cigars. Large cigars with a taxable price of less than 0.8823 cents are subject to a lower tax than the tax applicable to small cigars.

<sup>48</sup> The tax per small cigar post-CHIPRA is 5.033 cents. This rate equals the tax paid on a large cigar with a taxable price of 9.5412 cents (52.75 percent of 9.5412 cents is 5.033 cents). Large cigars with a taxable price of less than 9.5412 cents per cigar are subject to a lower tax than the tax applicable to small cigars. Large cigars with a taxable price of more than 9.5412 cents per cigar are subject to a greater tax than the tax imposed on small cigars.

## **Roll-your-own tobacco and pipe tobacco**

Prior to CHIPRA, roll-your-own and pipe tobacco were taxed at the same rate, \$1.0969 per pound. Therefore, there was no need to distinguish between the two types of tobacco and the tobacco manufacturers faced no tax incentive to favor one type of tobacco over the other.

CHIPRA raised the tax rate on roll-your-own tobacco to an amount that is approximately equivalent to the rate imposed on manufactured cigarettes,<sup>49</sup> while the tax rate on pipe tobacco increased in the same proportion that the tax rate on cigarettes increased.<sup>50</sup> CHIPRA increased the tax rate on roll-your-own tobacco from just less than \$1.10 per pound to \$24.78 per pound while the tax rate on pipe tobacco increased from just less than \$1.10 per pound to about \$2.83 per pound. Consequently, the tax rate applicable to pipe tobacco is approximately one-ninth the tax rate applicable to roll-your-own tobacco. This disparate tax treatment created both the need to differentiate between the two types of tobacco as well as a strong tax incentive for manufacturers to shift production, or change product labeling, from roll-your-own to pipe tobacco where feasible.

The Internal Revenue Code distinguishes roll-your-own and pipe tobacco by its appearance, type, packaging or labeling. Where these characteristics make the tobacco “suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes or cigars, or for use as wrappers thereof,” the tobacco is classified as roll-your-own and subject to the higher tax rate. Where these characteristics make the tobacco “suitable for use and likely to be offered to, or purchased by, consumers as tobacco to be smoked in a pipe,” the tobacco is classified as pipe tobacco and subject to the lower tax rate. The use of characteristics such as packaging and labeling to distinguish two products, which are similar in appearance and type, provides manufacturers with a tax incentive to package and label products as pipe tobacco even if they recognize that many customers will use the product as roll-your-own tobacco.

## **Processed tobacco**

CHIPRA also created a new category of manufacturers and importers who are subject to regulation but not to Federal excise tax. Under CHIPRA, manufacturers and importers of processed tobacco are subject to the permit, inventory, reporting, packaging, and recordkeeping requirements. Processed tobacco is regulated under the Internal Revenue Code, but Federal excise tax is not imposed and no limitations are placed on the removal, distribution or sale of processed tobacco.

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<sup>49</sup> The definition of “cigarette” found in section II(m) of the Tobacco Master Settlement Agreement generally uses 0.0325 ounces of roll-your-own tobacco as the equivalent to one individual cigarette. This is not inconsistent with the information and packaging provided to consumers by roll-your-own manufacturers. Using this equivalency, 1,000 cigarettes contain 32.5 ounces, or 2.03125 pounds, of tobacco. In order for the tax on roll-your-own tobacco to equal that on commercially manufactured cigarettes, the tax applied to 2.03125 pounds of roll-your-own tobacco should yield \$50.33 (the same rate applied to 1,000 commercially manufactured cigarettes). This implies a tax rate of \$24.78 on one pound of roll-your-own tobacco.

<sup>50</sup> The tax rates on both cigarettes and pipe tobacco increased by 158 percent.

## B. The Moving Ahead for Progress in the 21<sup>st</sup> Century Act

As discussed further in Part III, the change in tobacco rates in CHIPRA, specifically the discrepancy it created between the high-tax rate on cigarettes and roll-your-own tobacco compared with the lower-taxed pipe tobacco, resulted in a change in the way some manufacturers and retailers promoted and marketed tobacco products. Manufacturers re-labeled traditional roll-your-own brands as pipe tobacco and retail establishments began to offer cigarette-rolling machines as an alternative to traditional packs of cigarettes. As noted in a floor statement by then Chairman of the Senate Finance Committee, Max Baucus, “The abuse is so prevalent that gas station owners now have cigarette rolling machines to facilitate the loophole. A customer purchases a bag of pipe tobacco and then uses the machine to roll cigarettes.”<sup>51</sup> Concerns such as those expressed by Chairman Baucus may have prompted Congress to include the MAP-21 provision closing the “loophole.”<sup>52</sup>

MAP-21 clarified that the definition of tobacco manufacturer under the Internal Revenue Code included any businesses (including retailers) providing roll-your-own cigarette machines to their customers.<sup>53</sup> Additionally, MAP-21 clarified that the person making a machine available for consumers to produce tobacco products for personal consumption or use is deemed to be the person making the removal with respect to any tobacco products produced by the machine and is, therefore, liable for any tax liability associated with the tobacco products produced by the machine. Furthermore, as tobacco manufacturers, the person making a roll-your-own cigarette machine available to a customer is subject to all of the statutory and regulatory requirements applicable to manufacturers of tobacco products.

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<sup>51</sup> Floor Statement by Senator Max Baucus, *Congressional Record - Senate*, March 14, 2012, p. S1652.

<sup>52</sup> See sec. 100122 of Pub. L. No. 112-141, codified at section 5702(d).

<sup>53</sup> *Ibid.*

### III. THE ROLE OF THE ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

TTB was established by the Homeland Security Act of 2002.<sup>54</sup> The Act split the Bureau of Alcohol, Tobacco and Firearms (“ATF”), which at the time was in the Department of Treasury, into two agencies: (1) the Bureau of Alcohol, Tobacco, Firearms and Explosives, which was established within the Department of Justice and is responsible for the enforcement of criminal laws and regulatory rules relating to the manufacture, use, and distribution of firearms and explosives, and under certain conditions, alcohol and tobacco; and (2) TTB, which remained in the Treasury Department and is generally responsible for the administration and enforcement of the tax laws relating to alcohol, tobacco, and firearms. In particular, TTB is responsible for the collection of excise taxes on alcoholic beverages, tobacco products and cigarette papers and tubes, and firearms and ammunition and for ensuring compliance with Federal regulations concerning the permitting, labeling, and marketing of alcohol and tobacco products. TTB has issued guidance related to the regulation of tobacco products, cigarette papers and tubes, and processed tobacco. This part discusses some specific TTB guidance that may be helpful to the Committee in its review of excises taxes on tobacco.

#### **Roll-your-own machines**

In 2010, in response to reports of cigarette-making machines operating in retail establishments, TTB issued a ruling holding that, “the proprietor of a retail establishment who is in the business of making cigarettes for others, or who facilitates the making of cigarettes by or for others by providing the use of a commercial cigarette-making machine at its premises is engaged in the business of a tobacco products manufacturer and must qualify for and obtain a permit from TTB to engage in such business.”<sup>55</sup> In the ruling, TTB equated the sale of cigarette-making materials and the provision of a cigarette-making machine to the manufacture of cigarettes. Under the ruling, retailers offering cigarette-making machines to their customers would be subject to all of the permitting, reporting, labeling, and other requirements imposed on manufacturers of cigarettes.

The TTB ruling prompted a legal complaint filed in the District Court of the Northern District of Ohio, seeking declaratory and injunctive relief and a temporary restraining order barring TTB from enforcing the ruling.<sup>56</sup> On December 14, 2010, the court granted the injunction. After passage of MAP-21, which clarified that retailers offering the use of roll-your-own machines to their customers were indeed manufacturers of tobacco products (see discussion in Part II), the injunction against TTB’s enforcement of the ruling was lifted and the case challenging the TTB determination was dismissed.<sup>57</sup>

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<sup>54</sup> Pub. L. No. 107-296, sec. 1111.

<sup>55</sup> TTB Ruling 2010-4, September 30, 2010, p.4, available at <http://www.ttb.gov/rulings/2010-4rule.pdf>.

<sup>56</sup> *RYO Machine Rental, LLC, et al. v. U.S. Department of Treasury*, Alcohol and Tobacco Tax and Trade Bureau, et al., Case No. 4:10-CV-2462, 2010 WL 5158880 (N.D. Ohio 2010).

<sup>57</sup> See TTB Announcement, August 28, 2012, available at [http://www.ttb.gov/announcements/ttb\\_announcement\\_ryo\\_on\\_6th\\_circuit\\_court\\_decision.pdf](http://www.ttb.gov/announcements/ttb_announcement_ryo_on_6th_circuit_court_decision.pdf); and *RYO Machine*,

## **Distinguishing roll-your-own and pipe tobacco**

The large disparity between the rates of tax applicable to roll-your-own and pipe tobacco resulting from CHIPRA, creates an incentive for manufacturers to prefer production of pipe tobacco over roll-your-own tobacco. The distinction in present law between roll-your-own and pipe tobacco is in the statutory definitions of the two tobacco products. As described in Part II, the statutory distinction relies on appearance, type of tobacco, packaging and labeling to determine if the tobacco is “suitable for use and likely to be offered to, or purchased by, consumers” for making cigarettes, cigars, or wrappers (roll-your-own tobacco), or for tobacco to be smoked in a pipe (pipe tobacco).<sup>58</sup> On its website, TTB states that it is currently evaluating methods to differentiate between roll-your-own and pipe tobacco and has signaled its intent to provide guidance in the near future.<sup>59</sup> Until such time as TTB provides such guidance, the website states that “the packaging and labeling of the products in question will have particular significance.”<sup>60</sup>

Over many years, TTB and its predecessor, ATF, have attempted to provide guidance on the distinction between these two types of tobacco. For example, in 1990, ATF issued guidance related to the “sequential solvent extraction method” which it deemed to “effectively assist in differentiating between pipe tobacco and other ‘smoking tobacco’” (which at that time was not subject to tax).<sup>61</sup> More recently, in July of 2010, TTB issued an advanced notice of proposed rulemaking to solicit public comments, due on or before September 20, 2010, related to standards proposed to distinguish between roll-your-own and pipe tobacco.<sup>62</sup> The advanced notice identified the need for regulatory standards to differentiate roll-your-own and pipe tobacco based on physical characteristics of the products. The notice describes various comments received from industry members and other interested parties. One commenter proposed that tobacco be classified as pipe tobacco only if the tobacco meets at least one of the following characteristics: (1) at least 18 percent of its weight consists of reducing sugars;<sup>63</sup> (2) the moisture content exceeds 22 percent of its weight; (3) its cut tobacco exceeds 1/8 inch in width; (4) at least 10 percent of its weight consists of Latakia, Perique, or Black Tobacco, or a combination of these tobaccos; or (5) at least 20 percent of its weight consists of flavoring, casing, or other non-tobacco content. Additional comments suggested consideration of grandfathering for pre-existing brands; reservations regarding the reliability of using certain

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*LLC v. U.S. Dept. of Treasury*, Alcohol and Tobacco Tax and Trade Bureau, Case No. 11-3163, 696 F.3d 467 (6<sup>th</sup> Cir. 2012).

<sup>58</sup> See sec. 5702(n) and (o), and the discussion in Part I of this document.

<sup>59</sup> See *e.g.*, TTB, Pipe Tobacco available at <http://www.ttb.gov/tobacco/pipe-tobacco.shtml>.

<sup>60</sup> *Ibid.*

<sup>61</sup> See ATF Proc. 90-2, 1990. The 1990 procedure modified a method that was described previously in ATF Procedure 76-2.

<sup>62</sup> TTB Notice No. 106, Federal Register 2010-17957, July 22, 2010.

<sup>63</sup> Total reducing sugars include all monosaccharides (*e.g.*, fructose, glucose, galactose) and disaccharides (*e.g.*, sucrose, lactose, maltose). See TTB Notice No. 65, *Tax Classification of Cigars and Cigarettes*, October 25, 2006, 71 Fed. Reg. 206, p. 62509.

physical characteristics (*e.g.*, cut width or tobacco blend) as guides to determine use or intended use; and suggestions related to the use of other characteristics such as menthol flavoring. In connection with the advanced notice of proposed rulemaking, TTB released, as supporting documentation, a laboratory comparison of pipe and roll-your-own tobacco products.<sup>64</sup> Subsequently, TTB reopened the comment period until October 24, 2011.<sup>65</sup> To date, TTB has not issued regulations on this issue.

### **Distinguishing cigarettes from cigars**

Prior to CHIPRA, tobacco products classified as small cigarettes were subject to higher excise tax rates than those classified as small cigars. Although CHIPRA equalized the rates on small cigars and small cigarettes, it is still possible for tobacco products that are similar to small cigarettes to be taxed at a rate lower than the rate applicable to small cigarettes. This is possible because the Internal Revenue Code does not include a minimum tax on large cigars. The distinction between small and large cigars is based solely on the weight of the product. Manufacturers have an incentive to add weight to cigars in order for them to be classified as lower-tax large cigars. This results in a lower tax on tobacco products that are similar to small cigarettes and continues to highlight the need to distinguish cigarettes from cigars.

In 1973, ATF issued a ruling clarifying some factors that distinguish cigarettes from cigars.<sup>66</sup> One factor ATF used to determine if the product is a cigar is that the filler must be substantially of tobaccos unlike those fillers used in ordinary cigarettes. Under the ruling, the filler must not have any added flavorings which would cause the tobaccos to taste or to have the aroma generally attributed to cigarettes. If the product is of the typical cigarette size and shape, has a typical cigarette-type filter, includes flue-cured or aromatic tobaccos, and is packaged in cigarette-type packaging, the product may be classified as a cigarette rather than a cigar. On the other hand, if the product is made predominantly of cigar-type tobaccos, with a distinctive cigar taste and aroma, it does not resemble a cigarette, and is not marketed in a cigarette-type package, it may be classified as a cigar under the ATF ruling.

TTB issued an advance notice of proposed rulemaking on October 25, 2006.<sup>67</sup> The notice proposed several factors for determining if a product should be classified as a cigarette. One factor was the total reducing sugars standard. Under this standard, if the filler contains more than three percent by weight of total reducing sugars, the filler is consistent with cigarette filler. Other factors include whether product has the typical size and shape of a cigarette, whether the product has a filter, or is marketed in traditional cigarette-type packaging. If these factors are present, then under the proposed rulemaking, the product may be consistent with a cigarette. The

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<sup>64</sup> TTB, *Laboratory Comparison of Pipe and Roll Your Own Tobacco Products*, available at [www.regulations.gov/#!documentDetail;D=TTB-2010-004-0026](http://www.regulations.gov/#!documentDetail;D=TTB-2010-004-0026).

<sup>65</sup> TTB Notice No. 120, August 24, 2011, 76 Fed. Reg. 164, p.52913.

<sup>66</sup> ATF Ruling 73-22, 1973, available at [www.ttb.gov/rulings/73-22.htm](http://www.ttb.gov/rulings/73-22.htm).

<sup>67</sup> TTB Notice No. 65, *Tax Classification of Cigars and Cigarettes*, October 25, 2006, 71 Fed. Reg. 206, p. 62502, available at [www.gpo.gov/fdsys/pkg/FR-2006-10-25/pdf/06-8835.pdf](http://www.gpo.gov/fdsys/pkg/FR-2006-10-25/pdf/06-8835.pdf).

comment period was extended until March 26, 2007.<sup>68</sup> To date, TTB has not issued regulations on this issue.

### **Large cigar *ad valorem* pricing**

Pre-CHIPRA, the tax rate on large cigars was 20.719 percent of the manufacturer's or importer's sales price, but not more than \$48.75 per thousand cigars (4.9 cents per cigar). Any cigar with a manufacturer's or importer's sales price of 23.6 cents or more was subject to the maximum tax on large cigars. For cigars subject to the maximum tax, any change in price, so long as the price was at least 23.6 cents per cigar, had no effect on the manufacturer's or importer's tax liability.

After CHIPRA, the tax rate on large cigars increased to 52.75 percent of the manufacturer's or importer's sales price, and the maximum tax increased to just over 40 cents per cigar. A cigar with a manufacturer's or importer's sales price of 76.3 cents or more per cigar is subject to the maximum tax. For cigars subject to the maximum tax, any change in price, so long as the price is at least 76.3 cents per cigar, has no effect on the tax liability. However, for cigars with a sales price of less than 76.3 cents per cigar, each reduction of one cent in price results in a tax reduction of 0.5275 cents per cigar. Therefore, there is a considerable incentive for manufacturers of cigars not subject to the maximum tax to lower the price on which the excise tax is computed.

TTB issued guidance in 1991 related to the determination of the sale price of large cigars.<sup>69</sup> The guidance clarifies that the sale price includes any charge incident to placing the cigars in condition ready for use. Any charge for coverings or containers is included in the sale price and if the cigar is packaged with a nontaxable article and sold as a unit, the tax applies to the portion of the sales price applicable to the cigar. The guidance also states that actual expenses incurred for transportation, delivery, insurance, and other delivery expenses are excluded from the sale price for tax purposes. Transportation charges incurred in the normal course of business and for the benefit of the manufacturer or importer, such as transporting cigars from a factory or port of entry to a warehouse or other facility, are not transportation charges incurred in connection with the sale to a purchaser and are not excluded from the sales price.

Under the Fair and Equitable Tobacco Reform Act of 2004,<sup>70</sup> beginning in 2005 and ending after 2014, the U.S. Department of Agriculture Commodity Credit Corporation imposes assessments on tobacco product manufacturers and importers. Assessment payments are not taxes imposed by the Internal Revenue Code, or State sales taxes. TTB guidance provides that these payments are not excluded from the taxable sales price of large cigars.<sup>71</sup>

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<sup>68</sup> TTB Notice No. 69, *Re: Notice No. 65*, November 21, 2006, 71 Fed. Reg. 233, p.7046, available at [www.gpo.gov/fdsys/pkg/FR-2006-12-05/pdf/E6-20506.pdf](http://www.gpo.gov/fdsys/pkg/FR-2006-12-05/pdf/E6-20506.pdf).

<sup>69</sup> TTB Industry Circular 91-03, January 1991, available at [www.ttb.gov/industry\\_circulars/archives/1991/91-03.html](http://www.ttb.gov/industry_circulars/archives/1991/91-03.html).

<sup>70</sup> Title IV of Pub. L. No. 108-357, Oct. 22, 2004.

<sup>71</sup> See TTB, *Frequently Asked Questions*, T25, available at [www.ttb.gov/tobacco/tobacco-faqs.shtml#t25](http://www.ttb.gov/tobacco/tobacco-faqs.shtml#t25).

The increase in the excise tax cap on large cigars under CHIPRA resulted in an increase in the number of large cigars in the market falling under the maximum tax for large cigars and thus subject to the *ad valorem* tax computation. In response to industry requests, TTB released an industry circular in 2011 describing the calculation of tax on imported large cigars.<sup>72</sup> The circular stated the general rule that the sale price which is the basis for the tax computation “is generally the price for which the manufacturer or importer sells the packaged cigars in an arm’s length transaction to an unrelated party, typically a wholesaler or distributor.”<sup>73</sup> For imported cigars, “the price the importer paid the foreign manufacturer to purchase the products is not the sale price for purposes of calculating the tax. Rather, the pertinent sale for purposes of calculating the tax is the sale *by* the importer (not the sale *to* the importer) in an arm’s-length transaction to an unrelated party.”<sup>74</sup> (Emphasis in the original.)

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<sup>72</sup> TTB Industry Circular 2011-03, April 26, 2011, available at [http://www.ttb.gov/industry\\_circulars/archives/2011/11-03.html](http://www.ttb.gov/industry_circulars/archives/2011/11-03.html).

<sup>73</sup> *Ibid.*

<sup>74</sup> *Ibid.*

#### IV. THE ROLE OF THE U.S. FOOD AND DRUG ADMINISTRATION IN REGULATING TOBACCO

On August 28, 1996, the FDA issued regulations governing access to and promotion of cigarettes and smokeless tobacco to children and adolescents.<sup>75</sup> Tobacco companies filed a lawsuit and sought summary judgment arguing that the FDA lacked authority to regulate tobacco products under its authority to regulate drugs and devices.<sup>76</sup> The U.S. Supreme Court in 2000 affirmed a lower court decision that the FDA did not have authority to regulate tobacco products.<sup>77</sup> In response to the U.S. Supreme Court's decision, Congress enacted the Family Smoking Prevention and Tobacco Control Act (the "Tobacco Control Act").<sup>78</sup>

The Tobacco Control Act gives the FDA the authority to regulate the manufacture, distribution, and marketing of tobacco products. The Tobacco Control Act is primarily targeted at preventing tobacco use by children and adolescents. It directs the FDA to issue regulations to restrict sales of cigarettes and smokeless tobacco to youth, restricts advertising and marketing to youth, prohibits certain claims by tobacco companies (including "light," "low," or "mild,"), and requires bigger, more prominent warning labels for cigarettes and smokeless tobacco. Additionally, the Tobacco Control Act requires owners and operators of tobacco companies to register with the FDA, allows the FDA to set standards for tobacco products (*e.g.*, nicotine and tar levels), and requires certain pre-approval prior to new products entering the market.

#### Definitions

The Tobacco Control Act includes definitions of "tobacco product," "cigarette," and other terms separate though similar to those found in the Internal Revenue Code. The following table includes a comparison of the Internal Revenue Code and the Tobacco Control Act definitions of some of the terms relevant to the discussion of excise taxes on tobacco.

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<sup>75</sup> 21 CFR Parts 801, 803, 804, 807, 820, and 897. 61 Federal Register 168, p.44396. For additional background related to the FDA's regulation of tobacco products, see C. Stephen Redhead and Todd Garvey, Congressional Research Service, *FDA Final Rule Restricting the Sale and Distribution of Cigarettes and Smokeless Tobacco* (CRS Report R41304), June 24, 2010.

<sup>76</sup> *Coyne Beahm, Inc. v. FDA*, 966 F. Supp. 1374 (M.D.N.C. 1997).

<sup>77</sup> *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000).

<sup>78</sup> Pub. L. No. 111-31, June 22, 2009.

Term	Internal Revenue Code <sup>79</sup>	Tobacco Control Act <sup>80</sup>
Tobacco Product	Cigar, cigarette, smokeless tobacco, pipe tobacco, and roll-your-own tobacco.	Any product made or derived from tobacco that is intended for human consumption, including any component, part, or accessory of a tobacco product (except for raw materials other than tobacco used in manufacturing a component, part, or accessory of a tobacco product).
Cigarette	(1) Any roll of tobacco wrapped in paper or in any substance not containing tobacco, and (2) 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 described in paragraph (1).	Any product that is a tobacco product that is (A) any roll of tobacco wrapped in paper or any substance not containing tobacco, and (B) 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 described in subparagraph (A). It includes tobacco in any form, that is functional in the product, 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 or as roll-your-own tobacco.
Cigarette tobacco	Not defined.	Any product that consists of loose tobacco that is intended for use by consumers in a cigarette.
Roll-your-own tobacco	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 to for making cigarettes or cigars, or for use as wrappers thereof.	Any tobacco product 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.

<sup>79</sup> The Internal Revenue Code definitions are generally found in section 5702 and are discussed in Part I of this pamphlet.

<sup>80</sup> Except as noted, the Tobacco Control Act definitions are found in section 101 of Pub. L. No. 111-31, section 3 of the Federal Cigarette Labeling and Advertising Act, Publ. L. No. 93-109; and 21 CFR section 1140.3.

<b>Term</b>	<b>Internal Revenue Code<sup>79</sup></b>	<b>Tobacco Control Act<sup>80</sup></b>
Cigar	Any role of tobacco wrapped in leaf tobacco or in any substance containing tobacco (other than any roll of tobacco which is a cigarette).	A tobacco product that (1) is not a cigarette, and (2) is a roll of tobacco wrapped in leaf tobacco or any substance containing tobacco. <sup>81</sup>
Small or Little cigar	A cigar weighing not more than three pounds per thousand.	Any product that is a tobacco product that is any roll of tobacco wrapped in leaf tobacco or any substance containing tobacco (other than any roll of tobacco which is a cigarette) and to which one thousand units weigh not more than three pounds. <sup>82</sup>
Smokeless tobacco	Any snuff or chewing tobacco.	Any tobacco product that consists of cut, ground, powdered, or leaf tobacco and that is intended to placed in the oral or nasal cavity.

### **Deeming regulations**

The initial authority granted by the Tobacco Control Act gave FDA the authority to regulate cigarettes, cigarette tobacco, roll-your-own tobacco, and smokeless tobacco. Additionally, the Tobacco Control Act granted FDA the authority to issue regulations under the law “deeming” other tobacco products, including accessory products, as tobacco products.

In April 2014, the FDA issued its notice of proposed rulemaking (the “Deeming Notice”) and requested comments for submission by July 9, 2014.<sup>83</sup> The Deeming Notice would deem certain products to meet the statutory definition of tobacco products. Once products are “deemed” to meet the Tobacco Control Act definition of tobacco products, such products fall under the regulatory authority of the FDA.

The notice proposed two alternatives for the scope of the deeming provision. The first alternative would deem all products meeting the statutory definition of “tobacco product,” except accessories of a proposed deemed tobacco product, to be subject to regulation. As described above, “tobacco product” is defined broadly and includes any product made or derived from

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<sup>81</sup> This definition, referring to the definition of “cigar” found in the Internal Revenue Code, is mentioned in the FDA notice of proposed rulemaking issued in April of 2014 (the “Deeming Notice”), discussed in more detail below. 79 Federal Register 80, April 25, 2014, p. 23142.

<sup>82</sup> The FDA does not currently regulate cigars. The definition of “little smokes” is relevant in the context of the Tobacco Control Act only to the prohibition on the FDA against banning all cigarettes, all smokeless tobacco products, all little cigars, all cigars other than little cigars, all pipe tobacco, or all roll-your-own tobacco products. Tobacco Control Act, sec. 101(b).

<sup>83</sup> 79 Federal Register 80, April 25, 2014, p.23142.

tobacco. According to the notice, this first alternative could include dissolvables, gels, hookah tobacco, electronic cigarettes, cigars, and pipe tobacco as deemed to fall under the FDA regulatory authority whereas these products are currently not regulated by the FDA. The second alternative excludes “premium cigars” from the deeming provision.

### **Roll-your-own/pipe tobacco warning letters**

On August 13, 2013, the FDA announced it had issued warning letters to three tobacco manufacturers and one tobacco retailer related to the offering for illegal promotion or sale of roll-your-own tobacco products labeled as pipe tobacco.<sup>84</sup> By way of example, one letter cited an internet retailer for several violations, including violations for offering flavored cigarette tobacco and advertising tobacco using the descriptor “light” without an appropriate FDA order in effect as required under the Tobacco Control Act and FDA regulations.<sup>85</sup> In particular, the company is cited for offering, under the “Pipe Tobacco” section of the website, several brands of tobacco which are promoted or labeled as pipe tobacco; however, according to the FDA, “the overall presentation of these products strongly suggests that they are intended for use in a cigarette.”<sup>86</sup> In addition to the four letters highlighted in the 2013 FDA announcement, the FDA issued several similar warning letters in 2014 addressing similar issues.<sup>87</sup> The warning letters advise the establishments to immediately correct the violations to comply with the applicable provisions of the Tobacco Control Act. Often, these warning letters result in no further action by the FDA after the establishments correct the violations identified by the FDA.<sup>88</sup>

Although the FDA has issued warning letters related to the issue of the possible misclassification of roll-your-own and pipe tobacco and for flavored tobacco, the primary role of the FDA under the Tobacco Control Act is not one of excise tax collection or enforcement.

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<sup>84</sup> See FDA News and Events, *FDA Issues New Warning Letters*, August 13, 2013, available at [www.fda.gov/TobaccoProducts/NewsEvents/ucm364781.htm](http://www.fda.gov/TobaccoProducts/NewsEvents/ucm364781.htm).

<sup>85</sup> See FDA warning letter, July 30, 2013, available at [www.fda.gov/ICECI/EnforcementActions/WarningLetters/2013/ucm363668.htm](http://www.fda.gov/ICECI/EnforcementActions/WarningLetters/2013/ucm363668.htm).

<sup>86</sup> *Ibid.*

<sup>87</sup> See FDA’s Electronic Reading Room - Warning Letters available at <http://www.accessdata.fda.gov/scripts/warningletters/wlSearchResult.cfm?qryStr=roll-your-own&webSearch=true>.

<sup>88</sup> See *e.g.*, FDA close out letter, September 17, 2013, available at [www.fda.gov/ICECI/EnforcementActions/WarningLetters/2013/ucm371140.htm](http://www.fda.gov/ICECI/EnforcementActions/WarningLetters/2013/ucm371140.htm).