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**U.S. Department of the Treasury  
Alcohol and Tobacco Tax and Trade Bureau  
John J. Manfreda, Administrator  
Before the  
U.S. House of Representatives  
Committee on Ways and Means  
Subcommittee on Oversight**

Mr. Chairman, Congressman Boustany, and distinguished members of the Subcommittee, I am pleased to testify on the Alcohol and Tobacco Tax and Trade Bureau's (TTB) recent enforcement efforts in regards to tobacco. We greatly appreciate your interest in our Bureau.

**TTB's Jurisdiction**

The Internal Revenue Code of 1986 (IRC), 26 U.S.C. chapter 52, imposes federal excise taxes on tobacco products and cigarette papers and tubes, and establishes a comprehensive civil and criminal framework to address the tobacco trade from a federal tax perspective. The Secretary of the Treasury administers these provisions and has delegated this authority to TTB, which collected over \$16.2 billion in tobacco excise taxes between April 2009 and March 2010.<sup>1</sup>

The IRC and its implementing regulations establish qualification criteria to engage in the businesses of manufacturing, importing, or exporting tobacco products, and manufacturing or importing processed tobacco, and authorizes the issuance of permits to persons to engage in these activities, provided they meet the qualification criteria.<sup>2</sup>

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<sup>1</sup> TTB also administers the provisions of the IRC relating to distilled spirits, wine, and beer (26 U.S.C. Chapter 51), relating to excise taxes on firearms and ammunition (26 U.S.C. sections 4181 and 4182 and portions of chapter 32), and relating to general rules of tax procedure, with respect to the commodities indicated here including related criminal provisions. In addition, TTB administers the Federal Alcohol Administration Act (27 U.S.C. chapter 8, subchapter I), which covers basic permits, unfair trade practices, and labeling and advertising of alcohol beverages; the Alcoholic Beverage Labeling Act of 1988 (27 U.S.C. chapter 8, subchapter II), which requires a specific "Government Warning" statement on alcohol beverage labels; and the Webb-Kenyon Act (27 U.S.C. sections 122-122b), which prohibits the shipment of liquor into a State in violation of State law.

<sup>2</sup> Under the IRC, tobacco products include cigars, cigarettes, smokeless tobacco (chewing tobacco and snuff), pipe tobacco and roll-your-own tobacco. TTB also administers the federal excise tax on cigarette papers and tubes. TTB regulations define processed tobacco to mean any tobacco that has undergone processing, but that does not include tobacco products. The processing of tobacco includes, but is not limited to, stemming (that is, removing the stem

Tobacco product retailers, wholesalers, and distributors of tobacco products are not required under the IRC to obtain a TTB permit, and TTB has only limited jurisdiction over these entities.

Under the IRC, manufacturers of tobacco products and export warehouse proprietors must file a bond that relates to the tax liability for the tobacco products on the premises covered by the permit. The IRC and implementing regulations also include recordkeeping and reporting requirements designed to ensure the proper accounting of the product from the point of imposition of tax, e.g., upon manufacture, to the point of removal from the permitted premise, to ensure that the tax imposed upon the tobacco product is either paid or that adequate documentation exists to substantiate that no payment is due.

With regard to the federal excise tax on tobacco products, the IRC imposes the tax upon the manufacture and importation of tobacco products, and the tax is determined when the tobacco product is “removed” from the manufacturer’s premises or released from customs custody. TTB collects the federal excise tax on tobacco products removed from the facilities of domestic manufacturers for consumption in the United States. The tax upon tobacco products is payable by return. With regard to imported products, U.S. Customs and Border Protection (CBP) collects federal excise tax along with applicable duties on tobacco products upon importation into the United States. There are several exemptions from the tax, including when tobacco products are transferred to the bonded premises of another manufacturer, or when products are shipped for export. Processed tobacco is not subject to federal excise tax.

As a means to enforce these provisions, subtitles E and F of the IRC provide certain enforced collection options, civil and criminal penalties, permit suspension and revocation, and forfeiture provisions to ensure that the tax is collected and to deter future violations.

## **TTB Enforcement Profile**

TTB uses a coordinated approach in implementing its tobacco tax enforcement strategy. TTB revenue and permit specialists evaluate and process permit applications and tax returns to ensure that only qualified persons obtain permits to operate in the tobacco trade and to ensure that permittees comply with the IRC requirements imposed upon them. TTB’s Intelligence Division collects and analyzes data from a number of sources to identify potential diversion cases and develops leads for further investigation and/or audit, and identifies trends and schemes utilized to facilitate diversion and tax fraud so that our auditors and investigators can address unlawful diversion as early as possible. TTB investigators conduct background investigations on permit applicants to verify the accuracy of the permit application and to ensure that qualification criteria are met. Along with TTB auditors, the investigators pursue leads suggesting unlawful operations in

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from the tobacco leaf), fermenting, threshing, cutting, or flavoring the tobacco, or otherwise combining the tobacco with non-tobacco ingredients.

violation of the IRC and also conduct routine investigations and audits based upon risk and random factors. TTB also operates a tobacco laboratory, which analyzes products and develops analytical methods to ensure the appropriate tax classification of tobacco products and which also lends analytical support to tobacco diversion audits and investigations. Finally, pursuant to the FY 2010 Consolidated Appropriations Act, TTB was appropriated \$3 million, expendable over two years, to hire, train, and equip special agents to enforce its criminal jurisdiction. TTB is in the process of effecting that directive.

## **Tobacco Diversion**

On April 1, 2009, the Federal excise tax on cigarettes was increased more than 150 percent, creating a greater incentive to evade Federal taxes. Tobacco diversion refers broadly to the movement of tobacco products into domestic commerce without the payment of taxes due. Common diversion schemes include the following: Tobacco products are removed from the manufacturer's premises in excess of the quantity reported to TTB, thus evading the tax on the unreported quantity of products removed.

- Tobacco products are removed from the manufacturer's premises for export (which is a removal not subject to Federal excise tax) and either the manufacturer or an export warehouse proprietor diverts the products into domestic commerce before export, thus illegally avoiding tax payment.
- Tobacco products are removed from the manufacturer's premises without taxpayment for export, are exported, and are smuggled back into the United States without the required importation entry and associated tax payment.
- Tobacco products are smuggled from abroad into the United States, disguised and declared as something other than as tobacco products, or are declared as a smaller quantity than actually imported, thus illegally evading the applicable tax payment requirements.
- Tobacco products are sold by mail order, phone, and over the Internet from domestic and foreign vendors and are delivered directly to the consumer, in a manner bypassing applicable federal and/or state tax payment requirements.
- Tobacco products are produced by a manufacturer operating without a permit and are removed for domestic consumption without the payment of applicable taxes.

TTB has seen each of these types of scenarios and has either addressed them administratively (where permittees have been involved) or worked with State or other federal agencies to address the unlawful conduct and collect the tax. For example, in one recent case involving the under-reporting of taxable removals and associated tax liability, TTB conducted an audit of a tobacco manufacturer and found the company had

underreported the federal tax due. As a result, TTB worked jointly with other Federal, state and local authorities to investigate the company and determined that the firm had underreported taxable removals of over 48 million cigarettes and failed to pay over \$950,000 in federal excise taxes. The company also was found to have filed false reports and returns with TTB, and was involved in a contraband cigarette trafficking scheme. In September 2009, the owner and the company pled guilty to the conspiracy to avoid federal excise tax on cigarettes and being part of a contraband cigarette trafficking scheme, and agreed to file amended tax returns, pay tax liabilities owed, and a forfeiture of over \$800,000. The owner was sentenced to imprisonment for one year and agreed to a 10-year ban from operating in the tobacco industry.

TTB has also conducted numerous diversion cases involving export warehouse proprietors. For example, in 2008, we concluded a joint investigation with another federal agency regarding the domestic sale of nontaxpaid cigarettes by a tobacco export warehouse proprietor with a federal excise tax liability of over \$85,000 (including penalties and interest). The company was charged with evading federal excise tax by falsely claiming sales to fishing vessels as tax exempt. TTB resolved the case administratively. In another case, TTB found several tobacco industry members selling nontaxpaid product domestically. TTB resolved these matters through its administrative authorities, including the collection of tax, penalties and interest, and the suspension and surrender of permits. It is important to note that in all the examples highlighted here, the cases involved pre-CHIPRA tax increase liabilities. Had the cases occurred post-CHIPRA, the affected federal excise tax liability could have been increased by over 150 percent.

### **Implementation of the Children's Health Insurance Program Reauthorization Act of 2009**

The Children's Health Insurance Program Reauthorization Act of 2009 (Pub. L. 111-3, "CHIPRA") was enacted on February 4, 2009. CHIPRA directed the Secretary of the Treasury to conduct a study concerning the magnitude of illicit tobacco trade in the United States and to submit to Congress recommendations for the most effective steps to reduce such illicit tobacco trade. Several other key provisions of CHIPRA include: increasing the Federal excise tax on all tobacco products, effective April 1, 2009, imposing a floor stocks tax upon all tobacco products held for sale on April 1, 2009, and imposing a new permit requirement for those engaged in manufacturing or importing processed tobacco (no associated tax upon processed tobacco was imposed). TTB's implementation of these provisions of CHIPRA are detailed below.

- **Tobacco Report.** The Department of the Treasury Report to Congress on Federal Tax Receipts Lost Due to Illicit Trade and Recommendations for Increased Enforcement ("Report"), dated February 4, 2010, was comprised of a study estimating the amount of federal tax receipts lost as a result of tobacco diversion. The Report also made several recommendations that, taken together and assuming appropriate resources to implement, would reasonably be expected to reduce tobacco diversion.

With regard to the study to estimate the amount of federal tax receipts lost as a result of tobacco diversion, the Department of the Treasury employed a method that compared the amount of taxes collected by Treasury to the taxes that would have been collected if the required tax had been paid upon all cigarettes reported as consumed.<sup>3</sup> Consumption data underlying the study was derived from the National Survey on Drug Use and Health (NSDUH) and the National Health Interview Survey (NHIS). At the time of the study, time series data on consumption and taxed sales were not available for time periods after the tax increase imposed by CHIPRA (which increased the federal excise tax from .39 per pack to \$1.01 per pack, over a 150 percent increase). Consequently, the Treasury study spanned the years 2002 through 2007, which were the most recent years that the required data were available. We expect consumption data for 2009 to become available in the fall of 2010. Once the data is available, we will begin our analysis of post-CHIPRA revenue loss.

Accurately measuring the amount of Federal tax receipts lost as a result of tobacco diversion and smuggling is difficult because these activities are, by definition, clandestine in nature. As such, any estimate of the extent of the illicit tobacco trade will have a window of uncertainty around it.

Another important concern regarding the revenue loss estimates in the study should be emphasized. That is, the use of survey data on consumption was problematic because, as survey experts agree, respondents tend to understate the true extent of their cigarette consumption. In fact, the study found that a comparison of taxable removals with self-reported consumption resulted in an apparent revenue overage, since reported tax removals exceeded consumption figures by 70 percent. Based on the implausibility of such a conclusion, correction factors would be needed to account for the prevalence of under-reporting of cigarette consumption depicted in the survey data. The study emphasized that the substantial uncertainty surrounding the degree of underreporting of cigarette consumption in survey data generates uncertainty about the magnitude of the federal tax receipts lost due to cigarette diversion.

As directed, the Report set forth several recommendations for reducing federal revenue loss as a result of diversion. The Report suggested additional areas for consideration after post-CHIPRA revenue figures become available, to determine whether these figures justify the additional controls that are offered. In particular, the Report recommended as follows:

- **Enhance the traceability of tobacco products.** The Report recommended that the Treasury Department work with the Food and Drug Administration (FDA) on a “track and trace” system that the FDA is authorized to develop under the Family

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<sup>3</sup> The study focused on cigarettes because the taxes on cigarettes constitute 96 percent of the federal excise tax collected on tobacco products. Our experience also indicates the smuggling of cigarettes far exceeds the smuggling of other tobacco products.

Smoking Prevention and Tobacco Control Act (Pub. L. 111-31, “Tobacco Control Act”), so that the system can be used to the extent possible for enforcement purposes. A “track and trace” system utilizes electronic means to track product as it moves through the distribution chain. Codes on packages, such as bar codes, may be scanned each time a package moves, facilitating the ability to monitor its whereabouts as well as to trace its origin and who has had possession of it. Records are kept in support of this information. A familiar example is commercial carriers who use “track and trace” systems to monitor the movement of packages. If implemented, such a system could allow, for example, a pack of cigarettes to be tracked from the manufacturer’s premises to a retailer’s premises, and would enable TTB to verify a manufacturer’s taxpayment and shipment records against a wholesaler’s record of receipts, and to verify the wholesaler’s shipment records against a retailer’s commercial records. A federal “track and trace” system could benefit both TTB and FDA’s missions, and promote consistency and efficiency in government. TTB has offered assistance to FDA in support of FDA’s development of this system.<sup>4</sup>

- **Evaluate existing criminal and civil penalty provisions applicable to tobacco diversion to determine whether they should be increased.** Because the excise tax on tobacco products increased as a result of CHIPRA, thus multiplying the potential profits to be gained from tobacco product diversion without a commensurate increase in penalties to deter persons from such illicit activity, the Report recommends evaluating whether the existing sanctions are sufficient to balance the increased incentive to evade federal excise taxes on tobacco.
- **Allow enforcement officials to pay investigative expenses with proceeds gained through undercover operations.** Currently, tobacco tax enforcement programs are funded principally through agency appropriations. The Report indicates that additional funding through the use of proceeds gained through undercover investigations would expand investigative resources without the use of additional appropriated funds, and would parallel authority for other federal undercover enforcement operations. This authority permits law enforcement agencies to offset expenses incurred in undercover operations with income

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<sup>4</sup> It should be emphasized that the development of a “track and trace” system is consistent with current negotiations of the World Health Organization’s Framework Convention on Tobacco Control (FCTC). (The United States has signed but has not yet ratified the FCTC.) Article 15.2(b) of the FCTC requires that the parties consider, as appropriate, developing a practical tracking and tracing regime that would further secure the tobacco distribution system and assist in the investigation of tobacco illicit trade. Moreover, the parties to the FCTC are also engaged in negotiations to establish an international agreement that focuses exclusively on tobacco smuggling called the “Protocol on Illicit Trade in Tobacco Products (Protocol). Article 7.3 of the current draft of the Protocol would require the implementation of a track and trace system for cigarettes within 5 years of the Protocol’s effective date, and all other tobacco products implementation within 10 years (since a tracing system for other tobacco products, which are irregularly packaged, presents a greater challenge and requires additional time for proper development). These implementation timelines are consistent with our own estimates as to times required to implement such a system.

earned during such operations, such as from sales receipts from undercover storefronts. If this authority were extended to TTB, tax enforcement officers would be able to effectively pursue certain large-scale undercover investigations through the use of recirculated or “churned” funds to make undercover purchases.

As indicated, the Report offered additional areas for further consideration following post-CHIPRA revenue figures, to determine whether the revenue loss figures justify additional controls. These areas were as follows:

- Evaluate the need to establish a “closed distribution system” by limiting lawful access to the distribution of tobacco products and imposing commercial records and similar requirements upon persons in the trade. Because permit, recordkeeping or reporting requirements do not currently apply to wholesalers or retailers, TTB must rely on their voluntary cooperation; their ability to produce the records is dubious, since they are not required to keep records under the IRC. The Report recommended that further study be conducted to determine whether post-tax increase compliance data justifies regulating all tiers of the production and distribution chain.
- Evaluate the need to restrict access to and sale of machinery that can be used to manufacture cigarettes, since access to tobacco products machines is currently unrestricted and there are currently no federal controls in place to prevent such machines from being acquired and used to illegally manufacture tobacco products.
- Evaluate the need for enhanced controls over Internet sales of tobacco products to curb tax evasion, since tobacco products delivered directly to the consumer may not be appropriately taxpaid.<sup>5</sup>
- Re-examine the approach to enforcement of tobacco tax law with respect to American Indians, by expanding cooperation with tribal authorities. TTB has undertaken a concerted and directed effort to bring manufacturers on American Indian lands in the northeast United States into compliance with the IRC. Longstanding differences and positions as to tribal sovereignty and the application of the IRC on American Indian lands, has required substantial cooperation between federal enforcement authorities and tribal representatives on the issue of tobacco tax compliance. While TTB has ensured that some

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<sup>5</sup> Note that after the release of the Report, the Prevent All Cigarette Trafficking Act of 2009 (Pub. L. 111-154, “PACT Act”) was enacted on March 31, 2010. The PACT Act amends the Jenkins Act (15 U.S.C. 376) to enhance regulation and enforcement of tax provisions related to internet and other sales and deliveries that take place between a buyer and seller who engage in transactions that are not face-to-face. These provisions require sellers of cigarettes and smokeless tobacco products in interstate commerce to report such sales to the U.S. Attorney General, as well as to state tobacco tax administrators (of the state in which the products are delivered). With limited exceptions, this Act also prohibits the mailing of cigarettes and smokeless tobacco through the U.S. Postal Service.

manufacturers are compliant, substantial challenges remain as to others, and the cost to the revenue and the public safety from non-compliance on these lands is substantial. As a means to facilitate compliance and to facilitate the health, safety and welfare of the parties on tribal lands, the Report recommended that consideration be given to sharing a portion of the revenue generated from legal manufacturing activities on tribal land with tribal entities and that the revenue reserved shall be restricted for the purpose of promoting the health, safety, and welfare of American Indians.

- **Post CHIPRA Collections.** As mentioned previously, CHIPRA amended chapter 52 of the IRC to increase the federal excise taxes on tobacco products and imposed a floor stocks tax upon tobacco products (except for cigars) held for sale on the effective date of the tax increase. The new tax rates went into effect on April 1, 2009. TTB's tobacco tax collections increased significantly as a result of CHIPRA. Prior to the passage of CHIPRA, from January 2008 to March 2009, TTB collected over \$8.4 billion in tobacco excise tax, the majority of this tax representing cigarette excise taxes totaling \$8 billion. After the passage of CHIPRA, for the period of April 2009 through March 31, 2010, the total tobacco excise tax collections increased to over \$16.2 billion on all tobacco excise taxes, with \$15 billion attributable to cigarette excise taxes alone. In addition, pursuant to CHIPRA, TTB administered the floor stocks tax, which is a one-time excise tax placed upon commodities subject to a tax increase; the floor stocks tax is equal to the difference between the new tax rate and the previous rate. TTB's floor stocks tax collections for FY 2009-2010 were \$1.2 billion and represent collections from hundreds of thousands of wholesaler and retailer dealers (who do not hold a permit with TTB) and manufacturers and importers (who are required to hold a TTB permit). TTB has also identified tobacco wholesalers and retailers that did not file and/or pay floor stocks tax or significantly underpaid this tax. Thus far, TTB has identified and assessed more than \$4 million of additional floor stocks tax plus penalties and interest. TTB will continue to audit non-filers and high risk under-filers of floor stocks tax.

CHIPRA also imposed new permit requirements for those engaged in the business of manufacturing and importing processed tobacco. TTB has granted 19 permits to manufacturers of processed tobacco, and there are 9 pending applications for such permits. TTB has issued permits to 179 importers of processed tobacco, and 11 applications for such permits are currently pending. TTB also required, pursuant to regulation, that manufacturers and importers of processed tobacco notify TTB of any sales of processed tobacco to non-permittees, such as exporters of processed tobacco or dealers in processed tobacco, so that we can detect persons who operate outside of the legal requirements. To date, TTB has received approximately 1500 reports of sales to non-permittees and is in the process of evaluating those reports for potential investigations.

- **Industry Trends Post-CHIPRA.** Since the enactment of the CHIPRA, TTB has seen a number of changes in the tobacco products industry, apparently in response to the new incentives created by the different tax rates imposed on the tobacco product categories. These new changes are detailed below:
  - **Pipe tobacco and roll-your-own tobacco.** TTB has seen a significant shift in the quantity of products reported to be removed as pipe tobacco and as roll your own tobacco.<sup>6</sup> Prior to the enactment of CHIPRA, the tax rates on pipe tobacco and roll-your-own tobacco were the same (\$1.0969 per pound). As a result of CHIPRA, the tax on pipe tobacco was increased to \$2.8311 per pound, while the tax on roll-your-own tobacco was increased to \$24.78 per pound. Because the two products are similar, and the tax on roll your own was increased so significantly, we believe that many who roll their own cigarettes have switched from roll-your-own tobacco to pipe tobacco and therefore we have seen a dramatic shift in the volume of pipe tobacco and roll-your-own tobacco reported as removed by domestic manufacturers. For example, in the year prior to CHIPRA, a combined total of over 23 million pounds of pipe tobacco and roll-your-own tobacco were removed for sale in the United States from domestic manufacturers. Of that amount 12.9 percent was pipe tobacco and 87.1 percent was roll-your-own tobacco. In the year since CHIPRA, the combined total of pipe tobacco and roll-your-own tobacco removed for sale in the United States by domestic manufacturers was 22.9 million pounds, of which 65 percent was reported to be pipe tobacco and 35 percent was reported to be roll-your-own tobacco. It is difficult to differentiate pipe tobacco from roll-your-own tobacco, but TTB is in the process of evaluating analytical methods and objective standards for differentiating between the two products for tax purposes. We intend to publish a notice in the Federal Register seeking comment upon classification standards regarding these products in the near future.
  - **Small cigars and large cigars.** TTB has also seen a notable shift in the cigar market since the passage of CHIPRA. In the year preceding the tax increase on April 1, 2009, of all cigars removed for sale in the United States by domestic manufacturers, 52.5 percent were small cigars (cigars weighing less than 3 pounds per thousand or less) and 47.5 percent were large cigars (cigars weighing over 3 pounds per thousand). In the year following April 1, 2009, these numbers were 11.3 percent for small cigars and 88.7 percent for large cigars. Specifically, while the tax rates imposed

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<sup>6</sup> Under the IRC, pipe 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 to be smoked in a pipe. 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 of cigars or cigarettes.

on small cigars and large cigars were both raised substantially under CHIPRA, the effect of the respective tax increases creates an incentive to produce large cigars since the tax rate upon large cigars is dependent upon the sale price from the manufacturer or importer. Depending on pricing, the large cigar excise tax can be significantly lower than the small cigar excise tax. Consequently, manufacturers began adding weight to their small cigars to qualify them as large cigars, and recognized net tax savings. For example, consider a cigar product that is packaged for the consumer in a 20-stick pack, and sold by the manufacturer to a wholesaler for \$1.00. If the cigar product weighs 3 pounds per 1,000 sticks or less, the federal excise tax on the 20-stick package is \$1.01 (that is, \$50.33 per 1,000 sticks applied to 20 sticks). If the cigar product weighs more than 3 pounds per 1,000 sticks, the federal excise tax on the 20-stick package is \$.5275 (that is, 52.75 percent of the price sold by the manufacturer).

- Cigars and cigarettes. Prior to the enactment of CHIPRA, distinguishing between cigars and cigarettes (particularly between small cigars and small cigarettes) had significant tax implications. The tax on small cigars was \$1.828 per 1,000 sticks, while the tax on small cigarettes was \$19.50 per 1,000 sticks. At that time, TTB was evaluating methods to establish an objective standard to distinguish between the two products for tax purposes and to minimize potential revenue losses from misclassification.<sup>7</sup>

As a result of CHIPRA, the tax on small cigars and small cigarettes was made equivalent, at \$50.33 per 1,000 sticks. While the tax issue was resolved by this parity, other laws distinguish between cigars and cigarettes, and impose more stringent regulatory restrictions upon cigarettes than cigars. For example, the Jenkins Act, recently amended by the PACT Act, applies restrictions on delivery and internet sales of cigarettes and smokeless tobacco products and on mailing of such products through the U.S. Postal Service, but these restrictions do not apply to cigars. Similarly, the Contraband Cigarette Trafficking Act, 18 U.S.C. chapter 114, makes it a federal felony for certain persons to traffic in contraband cigarettes or smokeless tobacco products; the CCTA, however, does not apply to cigars. Where cigarettes are more restrictively regulated than cigars, the incentive for misclassification remains. TTB recognizes this and intends to complete rulemaking to set forth objective, analytical standards for distinguishing between these products for Federal excise tax purposes. Not only would such standards facilitate compliance with the IRC but would also facilitate the effective administration of the other tobacco laws as provided above.

## Conclusion

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<sup>7</sup> To that end, on October 26, 2006, TTB published in the Federal Register (71 FR 62506) a notice proposing a set of standards to distinguish between cigars and cigarettes for tax purposes based on, among other characteristics, scientific analysis of the filler tobacco and physical features, such as the presence of an integrated filter. TTB received 29 comments in response and has since been focused on addressing the concerns raised in the comments.

Mr. Chairman, I sincerely appreciate the opportunity to speak with you and the Members today. TTB has come a long way since our inception just eight short years ago. We have established an extremely talented and motivated workforce that has, in spite of its small number, established an effective and fair regulatory presence in the industries we oversee. Having examined the regulated industry in our initial years, we are now focusing our attention upon those operating outside lawful channels, particularly in the area of tobacco, given the substantial financial incentive for unlawful diversion and the relative ease with which diversion schemes can be effected. We have used every resource available to us to enforce the IRC in this regard, including, as I've noted, administrative remedies and coordination with other federal, State and local authorities to ensure that the illegal activity is stopped. While we have only just begun, and while we are small in number and are still in the process of establishing a special agent workforce, I assure you that we take our mandate most seriously. As I am sure we all recognize, tobacco tax diversion has been and will continue to be a difficult problem given the endless possibilities for evolving schemes to outpace enforcement efforts. However, I do believe that the recommendations that we have set forth, with appropriate resources to implement them, will provide substantial progress in addressing the problem. I am honored to lead the fine women and men of the TTB and am proud of their dedication and innovation in addressing their responsibilities. I would be happy to discuss our tobacco tax enforcement program and answer any questions you may have.