

**2007 TTB**

# **Tobacco Industry Seminar**

**Federal Compliance Training for  
the Tobacco Industry**

*July 17, 2007*



Alcohol and Tobacco Tax and Trade Bureau

# Common Audit Findings

Tax Audit Division





# Statistics

- Since January 2004, the TTB Tax Audit Division (TAD) has performed approximately 456 audits.
  - Tobacco = 59
  - Alcohol = 355
  - Firearms = 42



## Statistics (cont'd)

- Total Federal Excise Tax (FET) paid in 2006 was \$17,100,000,000
  - Alcohol = \$9.2B, Firearms = \$2.5M
- FET paid for tobacco in calendar year 2006 account for 43 percent.

Cigarettes	\$ 7,112,923,827
Chewing Tobacco/Snuff	\$ 59,975,009
Cigars	\$ 195,881,972
Pipe/RYO	\$ 21,759,914
Tobacco Only Totals	\$ 7,390,540,722

# Tax Issues





# Excise Tax Payments

- Late excise tax payments
  - Payments must be made 14 days after reporting period  
(27 CFR 40.168)
- Late filed excise tax returns
  - Returns must be filed 14 days after reporting period  
(27 CFR 40.163)
- Taxpayers who exceed \$5M liability in one year must use Electronic Funds Transfer  
(27 CFR 40.165(a))



# Tax Issues

- Wrong tax rate used for large cigars  
(27 CFR 40.161)
  - Large cigars are taxable at 20.719 percent of the sales price not to exceed \$48.75 per 1,000
  - “Free cigars” discount the sale price
- Inventory shortages not taxpaid  
(27 CFR 40.255)





## Tax Issues (cont'd)

- Sales to military exchanges not taxpaid (27 CFR 45.31)
  - Only cigarettes paid for with appropriated funds and gratuitously given away can be tax free.
- No adequate proof of export (27 CFR 44.61-66)
  - I.C. 2004-3: Acceptable proof of export, which may include commercial records, such as purchase orders, production schedules, inland bills of lading, ocean bills of lading, accounts receivable, letter of credit, or proof of payment.



## Tax Issues (cont'd)

- Decreasing adjustments taken for imported cigarette returns from market (27 CFR 41.163)
  - A claim must be made and approved by the TTB National Revenue Center (NRC) for returns
- Incorrectly calculated taxable removals (27 CFR 40.161)



## Tax Issues (cont'd)

- Freight charges not included in sales price for large cigars (26 USC 4216)
- Monthly Report and Excise Tax Return do not match for removals (27 CFR 40.183)
  - Verification of taxes paid versus removals shown on Monthly Report





## Tax Issues (cont'd)

- Export documentation – TTB Form 5200.14 not properly maintained or completed (27 CFR 44.198)
- Employee cigarette consumption on and off factory not properly documented (27 CFR 40.231)

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU (TTB)  
PART I - NOTICE OF SHIPMENT  
TAXABLE ARTICLES WITHOUT PAYMENT OF TAX

1. MAILING address of the premises from which taxable articles are removed:

2. Serial Number (see instruction 1):

3. I am consigning and removing taxable articles, without payment of tax, from my

4. D:

accordance with 27 CFR 40.231, I am removing taxable articles from my possession of the United States by:

check only ONE (check all that apply):

Foreign country, Puerto Rico, or Possession of the United States

Common carrier

Parcel Post

Individual

Export Warehouse

Class 9 customs bonded warehouse operated by a duty-free enterprise (duty-free store)



## Tax Issues (cont'd)

- Tax-free cigarettes used for experimental purposes not properly supported (27 CFR 40.232)
- What are ***experimental purposes***?





## Experimental purposes are...

- Operations or tests carried out under controlled conditions to discover an unknown scientific principle or fact, to gather or confirm data about a known scientific principle or fact, or to test manufacturing, packaging, or other such equipment.
- For example, use by laboratories, hospitals, medical centers, institutes, or universities for scientific, technical, or medical research.



## Tax Issues (cont'd)

- Tax-free cigarettes used for experimental purposes not properly supported (27 CFR 40.232)
- What purposes are *not experimental*?
  - The uses of tobacco products outside the factory premises for advertising or consumer testing or as salespersons' or customers' samples are not experimental purposes.



## Tax Issues (cont'd)

- Large cigarettes (Class B) exceeding 3 pounds per 1,000 taxpaid at \$19.50 per 1,000 versus \$40.95 per 1,000 (27 CFR 40.11)
- Excise tax not paid on imported tobacco products (27 CFR 41.41)
  - Customs broker did not pay U.S. Customs and Border Protection



## Tax Issues (cont'd)

- Pipe tobacco packages overfilled to compensate for future weight loss due to aging (27 CFR 40.161)
- Destruction of in-bond product not approved by NRC (27 CFR 40.253)
- Cigarettes removed and exported did not have required export markings
  - Result is they can not be removed tax free!

# Compliance Issues





# Compliance Issues

- **Inaccurate Monthly Reports (27 CFR 40.202)**
  - Items misreported
  - Numerous amended reports
  - The Monthly Report is the primary tool used by the NRC to monitor activity and it is imperative they are accurate.
- **Late-filed Monthly Reports (27 CFR 40.202 (a))**



## Compliance Issues (cont'd)

- Taxpaid and non-taxpaid tobacco products not segregated (27 CFR 40.254)
  - Returns from market
- Destructions not approved and, if approved without supervision, form not signed and dated (27 CFR 40.253)
- Changes in officers and directors not reported to NRC within 30 days (27 CFR 40.103) could cause permit to terminate!



## Compliance Issues (cont'd)

- Permits not updated accordingly when changes occur (**27 CFR 40.62**)
  - Added space, plant diagram, tax paid area, etc.
- Bond not adequate (**27 CFR 40.133**)
- Daily records of activity not adequate or complete (**27 CFR 40.183**)
- Improper markings on packages
  - Permit number, quantity, tax class
  - Export markings





## Compliance Issues (cont'd)

- Monthly Reports and Excise Tax Returns signed by person without signing authority (27 CFR 40.68)
- Records not retained relating to daily activity (27 CFR 40.185)
  - Manufactured
  - Returned to Bond
  - Reduced to Materials
  - Etc.



## Compliance Issues (cont'd)

- Alternate reporting day not approved (27 CFR 40.181)
  - Calendar day unless approved
- Losses, other than theft, not adequately supported (27 CFR 40.472)
- Approved alternate procedure not followed





## Compliance Issues (cont'd)

- Special Tax Stamp not at all locations covered (27 CFR 40.35)
- All manufactured cigarettes not included in inventory (27 CFR 40.202). Special projects, R&D, end-runs, etc. not included.
- Relanded previously exported cigarettes. Only manufacturer or export warehouse can re-land (27 CFR 44.210)



## Compliance Issues (cont'd)

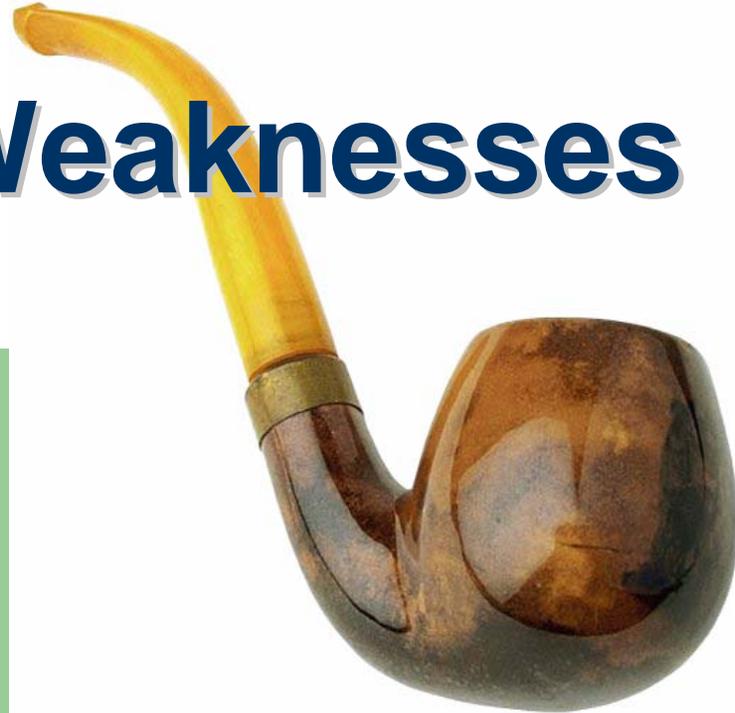
- Ending balances do not match beginning balances for next month (27 CFR 40.202)
- Plant file not available for inspection (27 CFR 40.76 and 27 CFR 40.185)
- Export warehouse destroyed cigarettes without notifying NRC (27 CFR 44.213)
- Destruction of imported cigarettes without notifying NRC (27 CFR 44.173)



## Compliance Issues (cont'd)

- Other operations not approved by NRC (27 CFR 40.72)
  - Plant must be exclusively used for manufacturing of tobacco products.
  - Other business, cut rag operations, etc.

# Control Weaknesses





# Control Weaknesses

- Disaster recovery procedures not in place
- Backup files not secured in separate location
- No written procedures for some areas of activity
- Passwords not required; data center not secured
- Numerous “shipping errors”



## Control Weaknesses (cont'd)

- Lack of sufficient backup personnel responsible for FET payments or reporting
- Lack of segregation of duties
- Terminated employees still on access lists

# Questions?

## Contact Information:

Tax Audit Division

(202) 927-9595

[ttbquestions@ttb.treas.gov](mailto:ttbquestions@ttb.treas.gov)

Visit [www.TTB.gov](http://www.TTB.gov) for  
more information!

