

Highlights of GAO-12-475, a report to congressional committees

Why GAO Did This Study

In 2009, CHIPRA increased and equalized federal excise tax rates for cigarettes, roll-your-own tobacco, and small cigars. Though CHIPRA also increased federal excise tax rates for pipe tobacco and large cigars, it raised the pipe tobacco tax to a rate significantly below the equalized rate for the other products, and its large cigar excise tax can be significantly lower, depending on price. Treasury collects federal excise taxes on tobacco products.

Also passed in 2009, the Family Smoking Prevention and Tobacco Control Act (Tobacco Control Act) granted FDA regulatory authority over tobacco products. This act directed GAO to report on trade in tobacco products, including the effects of differing tobacco tax rates. This report (1) reviews the market shifts in smoking tobacco products since CHIPRA; (2) examines the impact of the market shifts on federal revenue and Treasury's actions to respond; and (3) describes differences in FDA's regulation of various smoking tobacco products. GAO interviewed agency officials, industry members, and public health representatives. GAO analyzed tax and revenue data and reviewed relevant literature.

What GAO Recommends

As Congress continues its oversight of CHIPRA and Tobacco Control Act implementation, it should consider equalizing tax rates on roll-your-own and pipe tobacco and, in consultation with Treasury, consider options for reducing tax avoidance due to tax differentials between small and large cigars. Treasury generally agreed with GAO's conclusions and observations.

View GAO-12-475. View related [video clip](#). For more information, contact David Gootnick at (202) 512-3149 or gootnickd@gao.gov.

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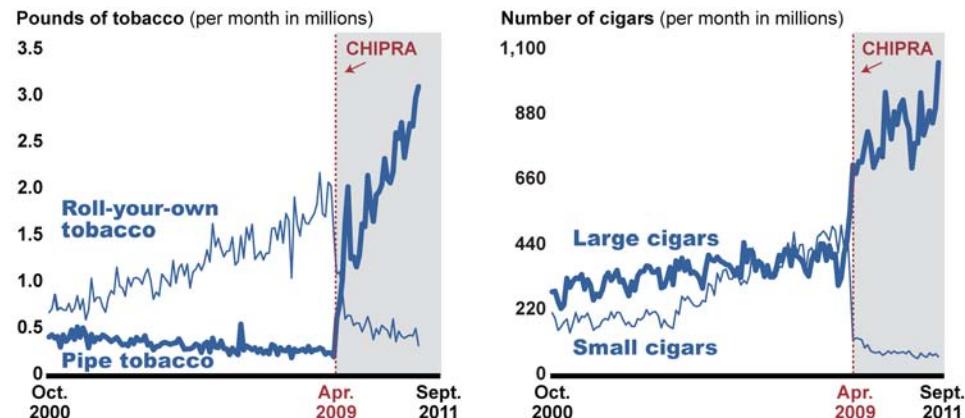
TOBACCO TAXES

Large Disparities in Rates for Smoking Products Trigger Significant Market Shifts to Avoid Higher Taxes

What GAO Found

Large federal excise tax disparities among tobacco products, which resulted from the Children's Health Insurance Program Reauthorization Act (CHIPRA) of 2009, created opportunities for tax avoidance and led to significant market shifts by manufacturers and price sensitive consumers toward the lower-taxed products. Monthly sales of pipe tobacco increased from approximately 240,000 pounds in January 2009 to over 3 million pounds in September 2011, while roll-your-own tobacco dropped from about 2 million pounds to 315,000 pounds. For the same months, large cigar sales increased from 411 million to over 1 billion cigars, while small cigars dropped from about 430 million to 60 million cigars (see figure). According to government, industry, and nongovernmental organization representatives, many roll-your-own tobacco and small cigar manufacturers shifted to the lower-taxed products after CHIPRA to avoid paying higher taxes.

FY 01-11 Monthly Sales for Roll-Your-Own and Pipe Tobacco, and for Small and Large Cigars



Source: GAO analysis of Treasury data.

While revenue collected for all smoking tobacco products from April 2009 through fiscal year 2011 amounted to \$40 billion, GAO estimates that federal revenue losses due to market shifts from roll-your-own to pipe tobacco and from small to large cigars range from about \$615 million to \$1.1 billion for the same period. The Department of the Treasury (Treasury) has limited options to respond to these market shifts. Treasury has attempted to differentiate between roll-your-own and pipe tobacco for tax purposes but faces challenges because the definitions of the two products in the Internal Revenue Code of 1986 do not specify distinguishing physical characteristics. Treasury also has limited options to address the market shift to large cigars and faces added complexity in monitoring and enforcing tax payments due to the change in large cigar tax rates.

Unlike cigarettes and roll-your-own tobacco, pipe tobacco and cigars are not currently regulated by the Food and Drug Administration (FDA) and thus are not subject to the same restrictions on characterizing flavors, sales, or distribution. In 2011, FDA indicated its intent to issue a proposed rule that would deem products meeting the statutory definition of "tobacco product" to be subject to FDA's regulation. However, FDA had not issued the proposed rule as of March 2012. FDA officials told GAO that developing the rule was taking longer than expected.