SMALL BUSINESS CIGAR COALITION
Comments for Senate Finance Committee
Tax Reform Working Group On
Community Development And Infrastructure
April 15, 2015

The Small Business Cigar Coalition (SBCC) appreciates the opportunity to submit these written comments for the record relating to tobacco excise taxes as the working group and the Finance Committee consider tax reform.

About the SBCC and its Members

The SBCC is a trade coalition of small cigar product manufacturers, marketers and component suppliers that employ fewer than 350 people, with the average number of employees between 100 and 150. The focus of the SBCC is exclusively cigars and cigar-related products (although some SBCC members offer other tobacco products as well). Small cigar manufacturers, wholesalers, importers and retailers together employ approximately 4,300 workers, while industry suppliers create an additional 48,660 U.S. jobs. It is estimated that over $1.5 billion in wages and almost $9 billion of economic activity are generated by this market segment.

Member companies commonly operate in economically depressed rural areas, some reestablishing closed manufacturing facilities, contributing to the revitalization of their communities, and providing competitive full-time salaries, health benefits, contributory 401(k)s and related retirement benefits. Together, these small manufacturers are responsible for creating and maintaining thousands of jobs in their companies, communities, ancillary component suppliers and wholesale/retail distribution networks, most of which are also small businesses. They pay significant amounts of income, sales, and excise taxes, as well as Master Settlement Agreement (MSA) payments (on cigarettes and roll-your-own cigarette tobacco) and FDA user fees, to localities, states and the U.S. Treasury that constitute the majority of the sale price of each tobacco product sold.

The SBCC was formed because small cigar manufacturers often face different issues than larger tobacco companies, and may be adversely affected by proposals that have little impact on larger companies.

Summary of Comments on Tax Reform

Cigar products experienced extraordinary tax increases that ranged from 155% on large cigars to over 2,600% on small cigars in a single year due to legislation adopted in 2009. Since 2009, cigar products have continued to face high levels of taxes at both the federal and state levels. Despite this high level of tax, there are a handful of proposals that are raised from time to time that seek again to increase taxes on these products significantly, typically to finance spending programs.[1] Some of these proposals are often mistakenly promoted as "loop-hole closers," while in fact they are clear tax increases. Such proposals would have a disproportionate impact on small businesses, and the jobs created by these businesses, without a related positive impact on health.

The SBCC believes that tax reform should not be used as a vehicle for tax increases. Congress has not recently considered any of the proposals noted above that would increase cigar excise taxes. As the Working Group and the Finance Committee consider various reform options, the SBCC simply requests the status quo with respect to tobacco excise taxes. That is, to protect American small businesses and their employees and customers, cigar taxes should not be increased, or modified in a way that has the effect of a tax increase on some or all products.

Key Points

Cigars are a small part of the overall tobacco market.

According to the Government Accountability Office (GAO), cigarettes continue to "dominate" the tobacco market, constituting almost 90% of the market, with all other tobacco products, including cigars, roll-your-own, and pipe tobacco, comprising the rest.

Cigar products were subject to unprecedented tax increases in 2009 and remain heavily taxed.

The Children's Health Insurance Program Reauthorization Act (CHIPRA), enacted in 2009, included substantial tobacco tax increases on all products, including cigars. With respect to large cigars, the rate (which is imposed on price) was increased by 155%, and the maximum tax per cigar was increased by 726%. In addition, for the first time, CHIPRA taxed small cigars at the same rate as cigarettes, raising the tax rate on small cigars from $1.83 per thousand cigars to $50.33 per thousand cigars, an extraordinary 2,653% tax increase in a single year.[2]

The Alcohol and Tobacco Tax and Trade Bureau (TTB), which is responsible for enforcing tobacco excise taxes, has reported that tobacco tax receipts have remained higher than they were in 2009, when CHIPRA was enacted, with about $14 billion in tobacco tax receipts in 2014.

In classifying products for tax purposes, cigar manufacturers are applying long-established rules set forth in the Internal Revenue Code.

Excise tax compliance involves the application of a specified rate of tax to a specified product. In applying tobacco excise taxes, manufacturers are applying long-established statutory definitions. The distinction between large and small cigars based on weight, for example, has

[1] See, for example, the President's Fiscal Year 2016 Budget Proposal, and S. 450, introduced by Senators Durbin, Blumenthal, Reed, and Brown.

[2] The Senate considered a transition rule that would have phased in the increase over a period from 3 to 5 years. Unfortunately, because of the dynamics of final consideration of CHIPRA, the Senate proposal was not considered because it would change the House bill and require a conference.

been in the law at least as far back as the 1950's. The current definitions of cigarettes and cigars have been in the law since 1965. These definitions were retained in the FDA Tobacco Control Act. Both TTB and the GAO have confirmed that manufacturers are complying with the law in the classification of cigar products. In summary, cigar manufacturers, by applying existing tax rates to clearly defined products as specified in the law, are complying with their tax responsibilities.

Additional tax increases focused on certain cigar products will disproportionately impact small businesses and their employees and customers.

The tobacco industry is diverse. Different companies make different types of products. Because of this diversity, some companies may not object (and may even support) certain tax changes, because their own products and market share will not be adversely affected. Small businesses cannot compete head-to-head with large manufacturers of well-known brand name products. The ability to use lower priced cigarette machines, which are often refurbished, to make machine-made cigar products enables small manufacturers to survive in a niche market.

Past proposals have sought to target certain products in a number of different ways. For example, one type of proposal would redefine "large" cigar. Such a change would be contrary to long-standing law. Moreover, as noted above, both TTB and GAO confirm that companies are properly classifying products and complying with their responsibilities. Another approach has been to impose a minimum tax on cigar sticks, which would have the effect of increasing taxes only on lower-priced cigars. Some have also suggested that "premium" cigars should be specially recognized in the law as a distinct and preferred tobacco product. American budgets and tastes come in all shapes and sizes. Just as not everyone can afford a million dollar home or to shop in the most expensive stores, not all budgets readily support the expense of higher-priced hand-rolled "premium" cigars. In short, "Joe the Plumber" should not be subject to higher tax simply because he (or his budget) chooses a lower priced product.

Conclusion

Our nation's tax laws are in need of reform in many areas, and the SBCC appreciates the difficult task the Working Groups and the Committee have ahead. As we move toward comprehensive tax reform, we should not use that process to increase taxes, particularly in ways that would disproportionately impact small businesses.