

**DESCRIPTION OF THE REVENUE PROVISIONS
OF THE
“CHILDREN’S HEALTH INSURANCE
PROGRAM REAUTHORIZATION ACT OF 2009”**

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INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the revenue provisions of the “Children’s Health Insurance Program Reauthorization Act of 2009,” scheduled for markup by the Senate Committee on Finance on January 15, 2009.

¹ This document may be cited as follows: Joint Committee on Taxation, “*Description of the Revenue Provisions of the Children’s Health Insurance Program Reauthorization Act of 2009*” (JCX-1-09), January 13, 2009. This document can also be found on the web at www.jct.gov.

I. INCREASE TOBACCO TAX RATES AND MODIFY CERTAIN DEFINITIONS

A. Increase Excise Tax Rates on Tobacco Products and Cigarette Papers and Tubes

Present Law

Rates of excise tax on tobacco products and cigarette papers and tubes

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:²

- Cigars weighing not more than three pounds per thousand (“small cigars”) are taxed at the rate of \$1.828 per thousand;
- Cigars weighing more than three pounds per thousand (“large cigars”) are taxed at the rate equal to 20.719 percent of the manufacturer’s or importer’s sales price but not more than \$48.75 per thousand;
- Cigarettes weighing not more than three pounds per thousand (“small cigarettes”) are taxed at the rate of \$19.50 per thousand (\$0.39 per pack);
- Cigarettes weighing more than three pounds per thousand (“large cigarettes”) are taxed at the rate of \$40.95 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 \$0.0122 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 \$0.0244 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;
- Snuff is taxed at the rate of \$0.585 per pound, and proportionately at that rate on all fractional parts of a pound;
- Chewing tobacco is taxed at the rate of \$0.195 per pound, and proportionately at that rate on all fractional parts of a pound;

² Sec. 5701. Except where otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended (the “Code”).

- Pipe tobacco is taxed at the rate of \$1.0969 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 \$1.0969 per pound, and proportionately at that rate on all fractional parts of a pound.

In general, excise taxes on tobacco products and cigarette papers and tubes manufactured in the United States are determined at the time of removal.

Floor stocks tax and foreign trade zones

Special tax and duty rules apply with respect to foreign trade zones. 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. The United States Customs and Border Protection agency of the Department of Homeland Security (“Customs”) 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 customs officer. Such articles may later be released back into the United States free of further taxes and duties.³

Description of Proposal

Rate increases

Under the provision, the rates of excise tax on tobacco products and cigarette papers and tubes are increased, generally in a proportionate manner. The special rules relating to the application of the tax rates to large cigarettes and cigarette papers and tubes longer than six and one-half inches apply under the provision in the same manner as under present law. The rates under the provision are as follows:

- Small cigars are taxed at the rate of \$50.00 per thousand (\$1.00 per pack);
- Large cigars are taxed at the rate equal to 52.4 percent of the manufacturer’s or importer’s sales price but not more than \$0.40 per cigar;
- Small cigarettes are taxed at the rate of \$50.00 per thousand (\$1.00 per pack);
- Large cigarettes are taxed at the rate of \$105.00 per thousand;
- Cigarette papers are taxed at the rate of \$0.0313 for each 50 papers or fractional part thereof;

³ 19 U.S.C. sec. 81c(a).

- Cigarette tubes are taxed at the rate of \$0.0626 for each 50 tubes or fractional part thereof;
- Snuff is taxed at the rate of \$1.50 per pound, and proportionately at that rate on all fractional parts of a pound;
- Chewing tobacco is taxed at the rate of \$0.50 per pound, and proportionately at that rate on all fractional parts of a pound;
- Pipe tobacco is taxed at the rate of \$2.8126 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 \$24.62 per pound, and proportionately at that rate on all fractional parts of a pound. The rate for roll-your-own tobacco is intended to approximate the rate for small cigarettes.

Floor stocks tax and foreign trade zone treatment

The provision imposes a tax on floor stocks. Taxable articles (i.e., those articles listed above), except for large cigars, manufactured in the United States or imported into the United States which are removed before April 1, 2009 and held on that date for sale by any person are subject to a floor stocks tax. The floor stocks tax is equal to the excess of the applicable tax under the new rates over the applicable tax at the present-law rates. The person holding the article on April 1, 2009 to which the floor stocks tax applies is liable for the tax. Each such person is allowed a \$500 credit against the floor stocks tax.

Notwithstanding any other provision of law, the floor stocks tax applies to an article located in a foreign trade zone on April 1, 2009, provided that internal revenue taxes have been determined, or customs duties have been liquidated, with respect to such article before such date, or such article is held on a tax-and-duty-paid basis on such date under the supervision of a customs officer.

For purposes of determining the floor stocks tax, component members of a “controlled group” (as modified) are treated as one taxpayer.⁴ “Controlled group” for these purposes means a parent-subsidiary, brother-sister, or combined corporate group with more than 50-percent ownership with respect to either combined voting power or total value. Under regulations, similar principles may apply to a group of persons under common control where one or more persons are not a corporation.

The floor stocks tax shall be paid on or before August 1, 2009, in the manner prescribed by Treasury regulations. In general, all of the rules, including penalties, applicable with respect to taxes on tobacco products and cigarette papers and tubes apply to the floor stocks tax. The Secretary of the Treasury or his delegate (“Secretary”) may treat person who bore the ultimate burden of the floor stocks tax as the person entitled to a credit of refund of such tax.

⁴ Controlled group is defined in section 1563.

Effective Date

The provision applies to articles removed after March 31, 2009.

B. Modify Definition of Roll-Your-Own Tobacco

Present Law

Federal excise taxes are imposed upon tobacco products and cigarette papers and tubes.⁵ Tobacco products are cigars, cigarettes, snuff, chewing tobacco, pipe tobacco, and roll-your-own tobacco. A “cigar” is any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco, other than any roll of tobacco which is a cigarette. A “cigarette” is (i) any roll of tobacco wrapped in paper or in any substance not containing tobacco; and (ii) 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. “Roll-your-own 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 for making cigarettes. “Cigarette paper” is paper, or any other material except tobacco, prepared for use as a cigarette wrapper. A “cigarette tube” is cigarette paper made into a hollow cylinder for use in making cigarettes.⁶

Wrappers containing tobacco are not within the definition of cigarette papers or tubes because they contain tobacco. They are also not generally within the definition of roll-your-own tobacco because they are usually used to make cigars, not cigarettes. For the same reason, loose tobacco suitable for making roll-your-own cigars is not considered to be roll-your-own tobacco.

Description of Proposal

Under the provision, roll-your-own tobacco also includes 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 cigars, or for use as wrappers for making cigars.

Effective Date

The provision applies to articles removed after March 31, 2009.

⁵ Sec. 5701.

⁶ Sec. 5702.

II. STRENGTHEN REGULATORY AND ENFORCEMENT AUTHORITY WITH RESPECT TO TOBACCO AND ALCOHOL

A. Permit, Inventory, Reporting, and Recordkeeping Requirements for Manufacturers and Importers of Processed Tobacco

Present Law

Tobacco products and cigarette papers and tubes are subject to Federal excise tax.⁷ Tobacco products are cigars, cigarettes, smokeless tobacco, pipe tobacco, and roll-your-own tobacco.⁸ Manufacturers and importers of tobacco products and export warehouse proprietors must obtain a permit from the Secretary of the Treasury or his delegate (“Secretary”).⁹ Manufacturers and importers of tobacco products or cigarette papers or tubes, and export warehouse proprietors, must also periodically make an inventory and certain reports and keep certain records, all as prescribed by the Secretary.¹⁰

Description of Proposal

The provision creates a new category of manufacturers and importers who are subject to regulation but not to Federal excise tax. Under the provision, manufacturers and importers of “processed tobacco” are subject to the present-law permit, inventory, reporting, and recordkeeping requirements. Processed tobacco is any tobacco other than tobacco products.¹¹ A manufacturer of processed tobacco is any person who processes any tobacco other than tobacco products, and an importer includes an importer of processed tobacco. However, the processing of tobacco does not include the farming or growing of tobacco or the handling of whole tobacco leaf solely for sale, shipment, or delivery to a manufacturer of tobacco products or processed tobacco. For example, under the provision an importer of “cut rag” tobacco or a leaf processor that manufactures such tobacco is subject to the general permit, inventory, reporting, and recordkeeping requirements of the Code but is not subject to Federal excise tax (unless it also imports or manufactures tobacco products or cigarette papers or tubes).

Under the provision, any person who is engaged in business as a manufacturer or importer of processed tobacco on the effective date of the provision and who submits a permit application within 90 days of the effective date of this provision may continue to engage in such business pending action on their permit application. Such persons will be subject to the

⁷ Sec. 5701.

⁸ Sec. 5702.

⁹ Sec. 5713.

¹⁰ Sec. 5721 (inventories); sec. 5722 (reports); sec. 5741 (records).

¹¹ Sec. 5702(c) defines tobacco products as cigars, cigarettes, smokeless tobacco, pipe tobacco, and roll-your-own tobacco.

requirements of this provision to the same extent as if the person was a permit holder while final action on the permit application is pending.

Effective Date

The provision is effective on April 1, 2009.

B. Broaden Authority to Deny, Suspend, and Revoke Tobacco Permits

Present Law

Manufacturers and importers of tobacco products and proprietors of export warehouses must obtain a permit to engage in such businesses.¹² 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, not likely to maintain operations in compliance with the applicable provisions of the Code; or (4) such applicant has failed to disclose any material information required or made any material false statement in the application.¹³ 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 Code and related regulations pertaining to taxes and regulation of tobacco products 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 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; or (4) has failed to maintain the business premises in such a manner as to protect the revenue.¹⁴

Description of Proposal

The provision broadens the present-law authority of the Secretary to deny, suspend, and revoke tobacco permits. Under the provision, the Secretary may deny an application for a permit if the applicant has been convicted of a felony violation of a Federal or State criminal law relating to tobacco products or cigarette papers or tubes, or if, by reason of previous or current legal proceedings involving a violation of Federal criminal felony laws relating to tobacco products or cigarette papers or tubes, such applicant is not likely to maintain operations in compliance with the applicable provisions of the Code.

Similarly, a permit may be suspended or revoked if the holder is convicted of a felony violation of a Federal or State criminal law relating to tobacco products or cigarette papers or tubes, or if, by reason of previous or current legal proceedings involving a violation of Federal criminal felony laws relating to tobacco products or cigarette papers or tubes, such applicant is not likely to maintain operations in compliance with the applicable provisions of the Code.

¹² Sec. 5713.

¹³ Sec. 5712.

¹⁴ Sec. 5713.

Effective Date

The provision is effective on the date of enactment.

**C. Clarify Statute of Limitations Pertaining to Excise Taxes
Imposed on Imported Alcohol, Tobacco Products
and Cigarette Papers and Tubes**

Present Law

Under the Code, amounts of tax must generally be assessed within three years after a tax return is filed, and no proceeding in court without assessment for the collection of such tax may begin after such period has expired.¹⁵ If no return is filed (but is required), the tax may be assessed, or a proceeding in court for the collection of such tax may be initiated without assessment, at any time.¹⁶

Customs collects duties and excise taxes on imports. Importers of taxable articles relating to tobacco and alcohol must file a tax return with Customs.¹⁷ In general, the limitations period for fixing and assessing duties and taxes with respect to an import is one year from the date of entry or removal.¹⁸ Under the applicable customs law, with some limited exceptions, any duty or tax imposed on an import is final and conclusive upon all persons, including the United States, unless a protest is filed within 180 days or a court action is timely commenced.¹⁹

Description of Proposal

The provision clarifies the tax and customs law in the area of alcohol and tobacco products by providing that, notwithstanding customs law, the general statute of limitations for assessment under the Code (sec. 6501) applies with respect to taxes imposed under chapters 51 (relating to distilled spirits, wines, and beer) and 52 (relating to tobacco products and cigarette papers and tubes) of the Code.

No inference is intended regarding the applicability of the statute of limitations under the Code to pending cases or to excise taxes imposed other than under chapters 51 and 52 of the Code.

Effective Date

The provision is effective for articles imported into the United States after the date of enactment.

¹⁵ Sec. 6501(a).

¹⁶ Sec. 6501(c)(3).

¹⁷ 24 C.F.R. sec. 41.81(b) (tobacco products and cigarette papers and tubes); sec. 5061(a) (distilled spirits, wines, and beer).

¹⁸ 19 U.S.C. sec. 1504(a). The Secretary may extend this period under certain circumstances and with notice to the importer.

¹⁹ 19 U.S.C. sec. 1514(a) & (c)(3).

D. Impose Immediate Tax on Unlawfully Manufactured Tobacco Products and Cigarette Papers and Tubes

Present Law

Manufacturers and importers of tobacco products and proprietors of export warehouses must obtain a permit to engage in such businesses.²⁰ A permit is obtained by application to the Secretary.²¹ A manufacturer of tobacco products or cigarette papers or tubes, or an export warehouse proprietor, must file a bond and obtain approval of such bond from the Secretary.²² In general, excise taxes on tobacco products and cigarette papers and tubes manufactured in the United States are determined at the time of removal. In the case of taxes on tobacco products and cigarette papers and tubes removed during any semimonthly period under bond for deferred payment of tax, payment is due no later than the 14th day after the last day of such semimonthly period.²³

Distilled spirits, wines, and beer produced at any place other than a place required by the Code are subject to tax immediately on production.²⁴ There is no such rule imposing immediate tax on tobacco products and cigarette papers and tubes that are produced by an out-of-compliance manufacturer.

Description of Proposal

Under the provision, in the case of any tobacco products or cigarette papers or tubes produced in the United States at any place other than the premises of a manufacturer that has obtained a permit (if required) and approval of a bond, the excise tax is due and payable immediately upon manufacture, unless they are produced solely for the person's own personal consumption or use.

Effective Date

The provision is effective on the date of enactment.

²⁰ Sec. 5713. A "manufacturer of tobacco products" does not include (1) a person who produces tobacco products solely for the person's own personal consumption or use, and (2) a proprietor of a customs bonded manufacturing warehouse with respect to the operation of such warehouse. Sec. 5702(d).

²¹ Sec. 5712.

²² Sec. 5711.

²³ Sec. 5703.

²⁴ Sec. 5006(c)(2) (distilled spirits); sec. 5041(f) (wines); sec. 5054(a)(3) (beer).

E. Use of Tax Information in Tobacco Assessments

Present Law

Section 6103 provides that returns and return information are confidential and may not be disclosed by the IRS, other Federal employees, State employees, and certain others having access to the information except as provided in the Code.²⁵ A “return” is any tax or information return, declaration of estimated tax, or claim for refund required by, or permitted under, the Code, that is filed with the Secretary by, on behalf of, or with respect to any person.²⁶ “Return” also includes any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.

The definition of “return information” is very broad and includes any information gathered by the IRS with respect to a person’s liability or possible liability under the Code.²⁷

However, data in a form that cannot be associated with, or otherwise identify, directly or indirectly a particular taxpayer is not "return information" for section 6103 purposes.

Section 6103 contains a number of exceptions to the general rule of confidentiality, which permit disclosure in specifically identified circumstances when certain conditions are satisfied.²⁸

²⁵ Sec. 6103(a).

²⁶ Sec. 6103(b)(1).

²⁷ Sec. 6103(b)(2). Return information is:

- a taxpayer’s identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer’s return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense,
- any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110,
- any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement, and
- any closing agreement under section 7121, and any similar agreement, and any background information related to such an agreement or request for such an agreement.

For example, under section 6103(o) of the Code, returns and return information with respect to the taxes imposed on alcohol, tobacco and firearms are open to inspection by or disclosure to officers and employees of a Federal agency whose official duties require such inspection or disclosure.

The Fair and Equitable Tobacco Reform Act of 2004²⁹ repealed the Federal tobacco support program and created a Tobacco Trust Fund. Funds from the Tobacco Trust Fund are used to provide transitional payments to tobacco quota holders and eligible tobacco producers. The Tobacco Trust Fund is funded by quarterly assessments paid by manufacturers and importers of tobacco products. The Farm Service Agency receives tax information from the Department of the Treasury's Alcohol and Tobacco Tax and Trade Bureau as part of its administration of the Tobacco Trust Fund assessments.

A September 2008 Department of Agriculture inspector general report indicated that a number of companies were delinquent in paying their assessments and have been referred to the Department of Justice for debt collection.³⁰ Section 6103(o) does not provide for the use of the tax information received in civil actions against the delinquent companies. The Department of Justice could proceed with the lawsuits based on information provided by other entities, other than the tax data.

Description of Proposal

The proposal provides that returns and return information provided to a Federal agency under section 6103(o) may be used in an action or proceeding, or in the preparation for an action or proceeding, brought under section 625 the Fair and Equitable Tobacco Reform Act of 2004 for any unpaid assessments or penalties arising under such Act.

Effective Date

The proposal is effective on and after the date of enactment.

²⁸ Sec. 6103(c) - (o). Such exceptions include disclosures by consent of the taxpayer, disclosures to State tax officials, disclosures to the taxpayer and persons having a material interest, disclosures to Committees of Congress, disclosures to the President, disclosures to Federal employees for tax administration purposes, disclosures to Federal employees for nontax criminal law enforcement purposes and to the Government Accountability Office, disclosures for statistical purposes, disclosures for miscellaneous tax administration purposes, disclosures for purposes other than tax administration, disclosures of taxpayer identity information, disclosures to tax administration contractors and disclosures with respect to wagering excise taxes.

²⁹ Title VI of the American Jobs Creation Act of 2004 (Pub. L. No. 108-357).

³⁰ U.S. Department of Agriculture, Office of Inspector General, Southeast Region, Report No. 03601-15-At, *Audit Report: Tobacco Transition Payment Program Tobacco Assessments Against Tobacco Manufacturers and Importers* (September 2008).

F. Study Concerning Magnitude of Tobacco Smuggling in the United States

Present Law

Present law does not require the Secretary to submit a tobacco smuggling study to Congress.

Description of Proposal

The provision requires the Secretary to submit to Congress a study concerning the magnitude of tobacco smuggling in the United States and to recommend the most effective steps to reduce it. The study would include a review of the loss of Federal tax revenue due to illicit tobacco trade in the United States, and the role of imported tobacco products in such illicit trade.

Effective Date

The study will be completed no later than one year after the date of enactment.

III. CORPORATE ESTIMATED TAX PROVISION

A. Modifications to corporate estimated tax payments

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability. For a corporation whose taxable year is a calendar year, these estimated payments must be made by April 15, June 15, September 15, and December 15. For tax years beginning on any date other than January 1, the payments are due in months of the fiscal year that correspond to the calendar year payment months.

Under the Tax Increase Prevention Act of 2005 (“TIPRA”), as amended, in the case of a corporation with assets of at least \$1 billion, the payments due in July, August, and September, 2013, shall be increased to 120.00 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Explanation of Provision

The provision increases the otherwise applicable percentage for 2013 (120.00) by 0.5 percentage points.

Effective Date

The provision is effective on the date of enactment.