Cigar Rights of America
Office of Government Affairs
300 New Jersey Avenue, NW
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Washington, DC 20001
April 15, 2015

Dear Senator Heller and Senator Bennet,

Thank you for your leadership on the Senate Finance Committee Community Development and Infrastructure Tax Reform Working Group. As a national advocacy organization dedicated to protecting the rights of the consumer retail tobacconist and the supply chain and manufacturers of premium cigars, Cigar Rights of America ("CRA") appreciates the opportunity to comment on tax reform proposals affecting small businesses.

CRA supports your efforts to improve the tax code and strengthen US businesses; however, we are concerned that several pending proposals, including a proposal in the President's budget request to raise excise taxes on tobacco products, would significantly and unfairly penalize small businesses offering premium cigars by:

(1) being inconsistent with sound tax policy;

(2) harming small businesses that suffered large tobacco excise tax increases as recently as 2009; and

(3) not promoting any significant public health benefit.

We also strongly believe that raising tobacco excise taxes would violate several of the principles and concerns laid out by Senate Finance Committee Chairman Orrin Hatch and Ranking Member Ron Wyden. These include economic growth, fairness, competitiveness, certainty for small business and the middle class, and supporting domestic job creation.

Current Law

In 2009, the Children's Health Insurance Program Reauthorization Act of 2009 ("CHIPRA") (Pub. L. 111-3) significantly raised taxes on several tobacco products, including premium cigars. Prior to CHIPRA, premium cigars were taxed at the greater of either 20.719% per cigar or not more than 4.875 cents per cigar. After CHIPRA, taxes on premium cigars rose to the greater of either 52.75% per cigar or not more than 40.26 cents per cigar, a **726%** tax increase on premium cigars. By comparison, taxes on small and large cigarettes increased by approximately 158% after CHIPRA.

Proposals to Raise Excise Taxes on Premium Cigars

There have been several proposals to increase tobacco excise taxes on premium cigars.[1] In particular, a proposal in the President's FY 2016 budget request would substantially increase excise taxes on premium cigars by imposing a new tax at "an approximately equivalent rate" as a proposed increase on cigarette excise taxes.[2] This translates to a tax increase of 93% compared to the post-CHIPRA rate, or approximately an additional 37.4 cents per cigar. When compared to the pre-CHIPRA tax rate, the cumulative amount would equal a **1,493%** tax increase on premium cigars. Excise taxes on all tobacco products would also be increased for inflation annually.

We also note that, given the ad valorem nature of the tax imposed on premium cigars, premium cigar manufacturers and retailers pay a larger tax per product sold by virtue of the fact that they cost more than other categories of tobacco products. In other words, as prices for premium cigars rise, manufacturers and retailers pay a larger percentage of taxes paid per product sold compared to tax due per other tobacco product sold, such as cigarettes or small cigars. Although current tax imposes a cap on the tax imposed on premium cigars, certain proposals would remove that provision as applied to large cigars (which include premium cigars). We believe that this is unfair to manufacturers and retailers of premium cigars and also ignores the much more significant and recent rate increases on premium cigars versus other tobacco products, as described above.

Supporters of these proposals claim that increased tobacco excise taxes on premium cigars would decrease harmful consumption and substantially improve health. In addition, they claim that such increases would "close loopholes," preventing the reclassification of products in order to avoid paying taxes. These goals, however, are based on misinformation, as it is not the recharacterization of other tobacco products as premium cigars that is at issue.[3]

The Proposed Tax Increases Are Inconsistent with Sound Tax Policy

Tobacco excise taxes are paid when placed into inventory and before sale to the consumer. Because cigars can sit in inventory for a period of time, there may be a significant delay before the cash flow is generated to cover the cost of the excise taxes that were paid upfront. This can substantially affect manufacturers and retailers by forcing them to borrow funds to tide them over or limiting their ability to purchase new inventory. Raising tobacco taxes, especially with regard to one time "floor stock" taxes imposed on inventory held at the time of a tobacco excise tax increase, will only make the business environment for manufacturers and retailers more costly and challenging.

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[1] S. 450, the Tobacco Tax Equity Act of 2015, imposes a new higher tax on premium cigars of $24.78 per pound and a proportionate tax at the like rate on all fractional parts of a pound but not less than 5.033 cents per cigar. Unlike previous versions of the bill, there is no ceiling on the rate of taxation for premium cigars.

[2] The president's budget request proposes to increase cigarette taxes to $97.50 per 1,000 units (or from $1.01 per pack to $1.95 per pack).

[3] *See* Patel, Rocky. "Tobacco: Taxes Owed, Avoided, and Evaded" testimony, July 29, 2014, before the U.S. Senate, Committee on Finance, *available at* http://www.finance.senate.gov/imo/media/doc/4.%20Patel%20Testimony.pdf

Though excises taxes are usually paid by a manufacturer, they are ultimately passed on to the consumer, meaning excise taxes directly increase the cost of a product. Excise taxes are also regressive, meaning lower-income households spend a greater portion of income on goods subject to federal excise taxes than those with higher incomes.

We believe that such tax increases are unfair to premium cigar consumers and will hamper growth and domestic job creation at premium cigar retailers. . We note that raising tobacco excise taxes violates the principles of economic growth, competitiveness, and certainty for small businesses, as premium cigar retailers will need to pay more excise taxes on held inventory without knowing when, or whether, they will be able to recoup those taxes.

In the past, excise taxes have been proposed to pay for programs with no connection to tobacco or its consumers. For example, in 2014 the President's budget request proposed higher excise taxes on tobacco products as "a relatively efficient way to generate revenue for important national priorities, such as providing high-quality preschool." We believe that imposing tax increases to fund a specific policy priority on an unrelated and narrow segment of the American economy is not sound tax policy. Moreover, using tobacco excise taxes on premium cigars to fund a policy initiative simply because it is "easy to administer" threatens to sacrifice the success of premium cigar small business owners and the jobs of their employees.

Proponents of "tobacco tax parity," or equalizing the taxation of tobacco products, claim that existing tax disparities among products encourage the tobacco industry to relabel or repackage products to avoid higher taxes. While this may be true for certain tobacco industry segments, in the case of premium cigars, the concern is overstated, as premium cigars are unique tobacco products that cannot be replicated or disguised through packaging techniques or other gimmicks.

Premium cigars are distinguishable from small cigars, which can be substituted for cigarettes, in several ways; for example, premium cigars are wrapped in 100 percent leaf tobacco; bunched with 100 percent tobacco filler; contain no filter, tip, or non-tobacco mouthpiece; and weigh substantially more than other tobacco products. Despite these differences, premium cigars are treated as "large cigars" under the Code, which are defined as a cigar that weighs at least three pounders per 1,000 count. As described above, we believe that there are significant physical and weight differences between premium and large cigars that justify different treatment under the Code. Recognizing the distinctions among tobacco products supports better criteria for tax policy and determining the appropriate rate of taxation of such products.

Raising Premium Cigar Taxes Hurts Small Businesses

Many retailers and manufacturers of premium cigars are small, family-owned shops—not "big tobacco"—that were hit hard by the recent economic crisis. As discretionary items, premium cigars are among the first purchases foregone when consumers are deciding how to make ends meet. For many retailers and manufacturers of premium cigars, raising tobacco excise taxes at this sensitive time, as the economy slowly recovers, could be the difference between bouncing back from hard financial times or shutting their doors. Repeatedly increasing taxes on premium cigars further weakens demand and jeopardizes the viability of these businesses.

Moreover, premium cigars are a niche market with a small adult consumer base, meaning that the actual amount of tax revenue received from premium cigars is low, relative to other sources. In fact, premium cigar taxation has historically constituted less than one percent of all national tobacco tax revenues. Despite these relatively insignificant revenues, premium cigars are nationally among the highest, most over-taxed commodities in the retail market.

Premium Cigars Do Not Pose the Health Risks of Cigarettes and Small Cigars

Tobacco excise taxes are also used to discourage consumption of tobacco. Supporters of these taxes assert that premium cigars pose the same health risks as cigarettes, and should therefore be taxed at the same level. However, there is, in fact, very little evidence of adverse health effects from smoking premium cigars. Premium cigars are not inhaled, are smoked in moderation, and do not contain chemical additives, and the only relevant scientific studies either fail to support a finding of adverse health effects or else have significant methodological flaws (such as conflating cigar and cigarette smokers). Importantly, premium cigars are not marketed to, nor smoked by, children.

In sum, premium cigar business owners and enthusiasts already carry their fair share of the tax burden and will be hurt by additional tobacco excise taxes. Given their unique characteristics, their consumer base, and the market for premium cigars, CRA strongly urges the Senate Finance Committee Community Development and Infrastructure Tax Reform Working Group to oppose additional tobacco excise tax increases on premium cigars.

Very truly yours,

/s/ Mike Copperman

Mike Copperman
Legislative Director

CC:
The Honorable Dan Coats, Member, Community Development and Infrastructure Tax Reform Working Group
The Honorable Tim Scott, Member, Community Development and Infrastructure Tax Reform Working Group
The Honorable Michael Bennet, Member, Community Development and Infrastructure Tax Reform Working Group
The Honorable Maria Cantwell, Member, Community Development and Infrastructure Tax Reform Working Group
The Honorable Bill Nelson, Member, Community Development and Infrastructure Tax Reform Working Group