

**U.S. Department of the Treasury
Alcohol and Tobacco Tax and Trade Bureau**

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Committee on Finance**

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Mr. Chairman, Ranking Member Hatch, and distinguished members of the Committee, thank you for this opportunity to testify on the Alcohol and Tobacco Tax and Trade Bureau's (TTB) enforcement activities related to tobacco. We greatly appreciate your interest in our bureau.

TTB's Jurisdiction

The Internal Revenue Code of 1986 (IRC), 26 U.S.C. chapter 52, imposes federal excise taxes on tobacco products and cigarette papers and tubes, and establishes a comprehensive civil and criminal framework to protect the revenue. The Secretary of the Treasury administers these provisions and has delegated this authority to TTB, which collected over \$14 billion in tobacco excise taxes in FY 2013. TTB's tax authority also extends to alcohol products and firearms and ammunition, which combined resulted in nearly \$9 billion in collections last year.¹ In total, under its IRC authority, TTB collected approximately \$23 billion in excise taxes in FY 2013, making TTB the third largest tax collection agency in the U.S. government.

With regard to tobacco, the IRC and its implementing regulations establish qualification criteria to engage in businesses relating to manufacturing, importing, or exporting tobacco products, and manufacturing or importing processed tobacco, and require that persons obtain permits to engage in these activities.² Tobacco product retailers, wholesalers, and distributors of tobacco products

¹TTB administers the provisions of the IRC relating to distilled spirits, wine, and beer (26 U.S.C. Chapter 51), firearms and ammunition excise taxes (26 U.S.C. sections 4181, 4182, and related portions of chapter 32), and the general rules of tax procedure with respect to these commodities (including related criminal provisions at 26 U.S.C. Chapters 68 and 75). In addition, TTB administers the Federal Alcohol Administration Act (27 U.S.C. chapter 8, subchapter I), which covers basic permits, unfair trade practices, and labeling and advertising of alcohol beverages; the Alcoholic Beverage Labeling Act of 1988 (27 U.S.C. chapter 8, subchapter II), which requires a specific "Government Warning" statement on alcohol beverage labels; and the Webb-Kenyon Act (27 U.S.C. sections 122-122b), which prohibits the shipment of liquor into a state in violation of state law.

²Under the IRC, tobacco products include cigars, cigarettes, smokeless tobacco (chewing tobacco and snuff), pipe tobacco, and roll-your-own tobacco. TTB regulations define processed tobacco to mean any tobacco that has

and processed tobacco are not required under the IRC to obtain a TTB permit, and TTB has only limited jurisdiction over these entities.

Under the IRC, manufacturers of tobacco products and export warehouse proprietors must file a bond that relates to the tax liability for the tobacco products on the premises covered by the permit. The IRC and implementing regulations also include recordkeeping and reporting requirements designed to ensure that TTB can verify that the tax on tobacco products is paid or determined or that adequate documentation exists to confirm that a tax exemption applies.

The federal excise tax on tobacco products is imposed upon the manufacture and importation of tobacco products. The tax is determined when the tobacco product is “removed” from the manufacturer’s premises or released from customs custody. TTB collects the federal excise tax on tobacco products removed from the facilities of domestic manufacturers for consumption within the United States. U.S. Customs and Border Protection (CBP) collects federal excise tax on imported tobacco products, along with applicable duties. There are several exemptions from the tax, including when tobacco products are transferred to the bonded premises of a manufacturer or when products are shipped for export. Processed tobacco is not subject to federal excise tax.

To enforce these provisions, subtitles E and F of the IRC provide TTB with certain enforced collection options (such as liens and levies), civil and criminal penalties, permit suspension and revocation procedures, and forfeiture provisions to ensure that the tax is collected.

TTB Enforcement Profile

TTB’s tax enforcement strategy employs a three-pronged approach that involves the development and application of multiple investigative tools to detect and address excise tax fraud and tobacco diversion through: (1) building risk models to assimilate large amounts of data to identify high-risk activity; (2) applying advanced investigative techniques to uncover illicit trade and fraudulent activity; and (3) deploying teams with diverse skill sets for large, complex cases.

undergone processing, but that does not include tobacco products. The processing of tobacco includes, but is not limited to, stemming (that is, removing the stem from the tobacco leaf), fermenting, threshing, cutting, or flavoring the tobacco, or otherwise combining the tobacco with non-tobacco ingredients. TTB also administers the federal excise tax on cigarette papers and tubes.

Over the last three years, TTB has expanded its use of these tools and techniques to deploy TTB's field personnel of approximately 65 auditors and 60 investigators to address identified areas of revenue risk.

TTB's enforcement strategy leverages the expertise and skills of TTB's approximately 465 employees. TTB revenue and permit specialists evaluate permit applications and operational reports to ensure that only qualified persons obtain permits to operate in the tobacco industry and that they operate in compliance with the IRC. Prior to issuing new permits, TTB conducts an investigation on high risk tobacco processor, manufacturer, or importer applicants to verify the accuracy of permit application information and ensure that the qualification criteria are met. TTB has also developed risk models to identify potential diversion and fraudulent activity. Through the use of these models, in conjunction with other intelligence, TTB analysts identify diversion trends and schemes, and refer high-risk cases for further field work. TTB auditors and investigators then pursue leads suggesting unlawful operations and conduct investigations and audits based upon both risk and random factors. TTB also operates a tobacco laboratory, which analyzes products and develops analytical methods to ensure the appropriate tax classification of tobacco products and lends analytical support to audits and investigations. As these cases develop, if there are indications of fraud and other criminal activity, they are referred to TTB's special agents for investigation and potential referral to the Department of Justice for prosecution.

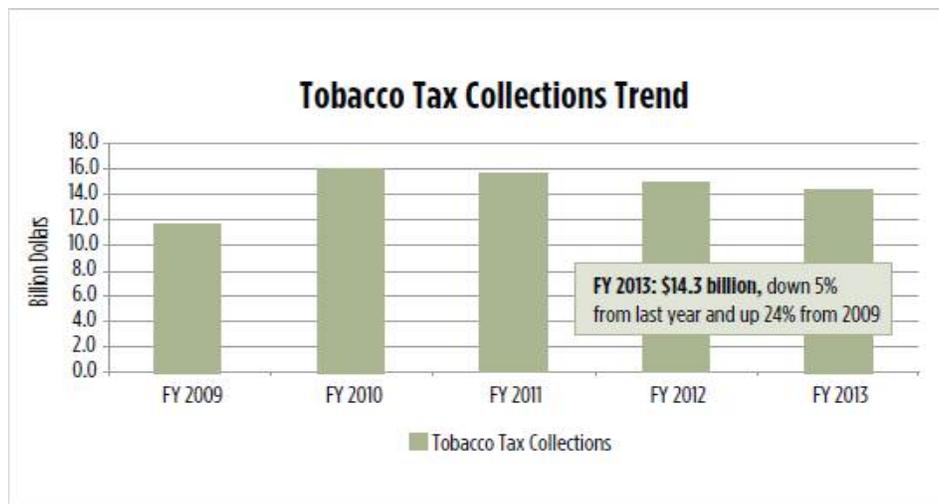
Children's Health Insurance Program Reauthorization Act of 2009

The Children's Health Insurance Program Reauthorization Act of 2009 (Pub. L. 111-3, "CHIPRA") was enacted on February 4, 2009. Among other things, CHIPRA increased the federal excise tax on all tobacco products; imposed a floor stocks tax upon all tobacco products held for sale on April 1, 2009 (except large cigars); and created a new permit requirement for those engaged in manufacturing or importing processed tobacco. The new tax rates, summarized in the below table, went into effect on April 1, 2009. Before CHIPRA, the tax rate on cigarettes was higher than the rates on roll-your-own tobacco, pipe tobacco, and small cigars; CHIPRA generally equalized the tax rate for cigarettes, roll-your-own tobacco, and small cigars. The tax rate for pipe tobacco was also increased, but to a significantly lower rate than roll-your-own

tobacco. In addition, CHIPRA significantly increased the ad valorem tax rate for large cigars as well as the maximum tax rate.

Item	Current Rate	Pre-CHIPRA Rate
Cigarettes --		
Small Cigarettes (no more than three pounds per thousand)	\$50.33 per thousand (\$1.01 per pack)	\$19.50 per thousand (\$0.39 per pack)
Large Cigarettes (more than three pounds per thousand)	\$105.69 per thousand	\$40.95 per thousand
Cigars --		
Small Cigars (no more than three pounds per thousand)	\$50.33 per thousand	\$1.828 per thousand
Large Cigars (more than three pounds per thousand)	52.75 percent of price for which sold, not to exceed \$402.60 per thousand	20.719 percent of price for which sold, not to exceed \$48.75 per thousand
Roll-Your-Own Tobacco	\$24.78 per pound	\$1.0969 per pound
Pipe Tobacco	\$2.8311 per pound	\$1.0969 per pound
Snuff	\$1.51 per pound	\$0.585 per pound
Chewing Tobacco	\$0.5033 per pound	\$0.195 per pound
Cigarette Papers	\$0.0315 for each 50 papers	\$0.0122 for each 50 papers
Cigarette Tubes	\$0.0630 for each 50 tubes	\$0.0244 for each 50 tubes

As illustrated by the below graph, the CHIPRA tax changes have resulted in increased tobacco tax collections by TTB, although the amount of the increase has decreased steadily since FY 2010, the first full fiscal year following CHIPRA. Overall, however, tobacco tax collections remain higher than in FY 2009, the year during which CHIPRA was enacted.



Immediately following the passage of CHIPRA, TTB administered the floor stocks tax, which is a one-time excise tax placed upon products subject to a tax increase. The floor stocks tax is equal to the difference between the new tax rate and the previous rate and is imposed on products that have been removed subject to tax from a manufacturer's premises or upon release from customs custody but that have not yet been sold at retail by wholesalers and retailers. TTB also identified tobacco product wholesalers and retailers who did not file and/or pay floor stocks tax or significantly underpaid this tax, and followed up with audits and investigations to ensure that all taxes due were properly paid. From FY 2009 through FY 2013, TTB collected more than \$1.2 billion in floor stocks tax.

In addition, CHIPRA imposed new permit requirements for manufacturers and importers of processed tobacco, which is generally tobacco that has been processed for use by manufacturers of tobacco products to make tobacco products. As such, it is not subject to tax. There are currently 30 TTB-permitted manufacturers of processed tobacco and 170 permitted importers of processed tobacco. TTB required through regulation that manufacturers and importers of processed tobacco notify TTB of any sales of processed tobacco to non-permittees to provide insight into the movement of this untaxed tobacco. In FY 2013, approximately 185 million (23 percent) of the roughly 831 million pounds of processed tobacco removals reported to TTB (excluding exports) were shipped to entities that do not hold a federal permit with TTB.

Although some of these removals represent sales to brokers, who may ultimately sell processed tobacco to a TTB-permitted manufacturer of tobacco products, others removals may be ultimately destined for illicit production. TTB analyzes this information, in conjunction with other intelligence, to select and prioritize its audits and investigations. As a result of these enforcement efforts, TTB has identified through its investigations to date approximately \$180 million in unpaid federal excise taxes; some of these cases have resulted in referrals for criminal investigation.³

³The Administration's FY 2014 and FY 2015 Budgets proposed to clarify that roll-your-own tobacco includes any processed tobacco that is removed or transferred for delivery to anyone without a proper permit, but does not include export shipments of processed tobacco. This provision would provide TTB with authority to collect tax on all processed tobacco when it is removed by the manufacturer or importer for delivery to any non-permitted domestic entity.

Tobacco Industry Trends Post-CHIPRA

The tax rate changes and resulting tax differentials enacted through CHIPRA created new incentives for manufacturers, importers, and consumers of certain tobacco products. These trends, and TTB's actions in response to each of them, are detailed below.

Cigars and cigarettes: Prior to CHIPRA, there was a significant tax differential between cigars and cigarettes (particularly between small cigars and small cigarettes). The tax on small cigars was \$1.828 per 1,000 sticks, while the tax on small cigarettes was \$19.50 per 1,000 sticks. At that time, TTB was working to establish an objective standard to distinguish between the two products for tax purposes and to minimize potential revenue losses from misclassification. To that end, in October 2006, TTB published in the Federal Register a notice proposing a set of standards to distinguish between cigars and cigarettes for tax purposes based on, among other characteristics, the filler tobacco and physical product features, such as the presence of an integrated filter (71 FR 62506). CHIPRA, however, equalized the tax on small cigars and small cigarettes, at \$50.33 per 1,000 sticks. Since then, TTB's intelligence, audits, and investigations have not found evidence of widespread misclassification of cigarettes as cigars under the IRC.

Although the incentive for misclassification of cigarettes as cigars for federal excise tax purposes was removed by CHIPRA, other laws distinguish between cigars and cigarettes, with more stringent regulatory restrictions imposed upon cigarettes than cigars.⁴ As such, we intend to complete the 2006 rulemaking to set forth objective, analytical standards for distinguishing between these products for federal excise tax purposes. Based on comments received and internal analysis, TTB found the originally proposed factors to be insufficient for this purpose; TTB has since identified a different analytical standard that we intend to propose to distinguish between cigar-like and cigarette-like tobaccos. TTB is currently finalizing the method for this standard and will resume the 2006 rulemaking project upon completion.

⁴For example, the Jenkins Act, amended by the Prevent All Cigarette Trafficking Act, regulates the delivery and internet sales of cigarettes and prohibits their mailing through the U.S. Postal Service, but it does not apply to cigars. Similarly, the Contraband Cigarette Trafficking Act (CCTA), 18 U.S.C. chapter 114, makes it a federal felony for certain persons to traffic in contraband cigarettes; however, the CCTA does not apply to cigars. The Bureau of Alcohol, Tobacco, Firearms and Explosives under the Department of Justice has primary jurisdiction for CCTA and Jenkins Act enforcement.

Small cigars and large cigars: TTB has, however, seen a notable shift in the cigar market since CHIPRA. Although CHIPRA substantially raised the tax rates imposed on both small cigars and large cigars, it also created an incentive to shift production to the large cigar category. The tax on large cigars is based on a percentage of the sale price from the manufacturer or importer, up to a maximum amount. Depending on pricing, the ad valorem excise tax on a large cigar can be significantly lower than the excise tax on a small cigar. Consequently, manufacturers may legitimately add weight to small cigars to qualify them for the large cigar tax rate, and then recognize net tax savings. In some instances, only minimal changes may be needed to add additional weight to a product so that it meets the definition of a large cigar, such as adding a small amount of tobacco.

Following CHIPRA, removals of domestic small cigars have decreased significantly, while there has been a dramatic increase in large cigar removals. In the 12 months preceding CHIPRA, of all cigars removed for sale in the United States by domestic manufacturers, 52 percent were small cigars and 48 percent were large cigars. During the post-CHIPRA period (from April 2009 through calendar year 2013), domestic large cigar removals increased to 93 percent of all cigars removed for sale, with domestic small cigar removals falling to 7 percent. Of domestic large cigar removals in the three years following CHIPRA, over 45 percent were made by companies that had switched the majority of their production from small to large cigars.

Large cigar ad valorem tax rate: Large cigars are the only tobacco product for which the excise tax is based on the manufacturer or importer's sale price; all other tobacco products are taxed at a flat rate based either on the number of units or the weight of the product. As noted above, the ad valorem tax on large cigars can result in a significantly lower tax on a large cigar than on a small cigar or cigarette, depending on the sale price of the large cigar. Since CHIPRA, which increased the maximum tax rate on large cigars to \$402.60 per thousand (from \$48.75 per thousand), the majority of large cigar removals by manufacturers and importers are taxed based on the sale price, minus allowable exclusions, instead of paying tax at the maximum tax rate. Before CHIPRA, 38 percent of domestic large cigars were sold below the maximum rate, whereas currently over 99 percent of domestic large cigars are sold below the maximum rate. This incentive to achieve the lowest possible sales price is reflected in the overall decrease in the average taxable sale price since CHIPRA.

Large cigar manufacturers may be lowering their taxable sale price in a number of ways. One common scenario is to “layer” their sales transactions. In some of these cases, manufacturers or importers insert an additional transaction with an intermediary into their distribution chain before the sale to a wholesaler or distributor. The transaction with the intermediary is at a low price. The manufacturer or importer and the intermediary sometimes establish this low price based on a special arrangement between them. Evidence of that special arrangement can be extremely difficult to obtain. The manufacturer or importer pays the ad valorem tax based on the low price to the intermediary, who resells the already taxed cigars to wholesalers or distributors at a much higher price. Although TTB has authority under the IRC to calculate the tax for these types of transactions based on a constructive sale price instead of the permitted taxpayer’s actual sale price, TTB must establish that the large cigars were sold by the manufacturer or importer through other than an arm’s length transaction at less than a fair market price. Such determinations can be complicated and resource-intensive, as the activity at issue can range from legal tax avoidance to illegal tax evasion, requiring a case-specific analysis of these transactions, which may include non-permitted foreign entities.

In addition, TTB has found that some manufacturers and importers of large cigars who had formerly been paying tax at the lower, pre-CHIPRA maximum rate are now more frequently taking unlawful exclusions from the taxable sale price.⁵ Auditing unlawful exclusions is also resource-intensive, complex, and increasingly results in litigation. Post-CHIPRA, the average tax collected per stick for domestic cigar removals has decreased almost 40 percent, from 7.21 cents per stick in FY 2010 to 4.4 cents per stick in FY 2014. The average post-CHIPRA tax collected per stick for imported large cigars has also decreased, from 10.5 cents per stick in FY 2010 to 6.67 cents per stick in FY 2014. TTB is actively pursuing audits and investigations related to large cigar pricing, with several civil cases pending in this area.

Other factors contributing to a decrease in the average post-CHIPRA large cigar tax rate are the entry of low-priced, smaller cigars that have added weight to fit into the large cigar tax category (as discussed in the preceding section) as well as increased overseas production, which may face lower production costs as compared to domestic production.

⁵Allowable exclusions are limited to expenses incurred in connection with the delivery of cigars to a purchaser, such as transportation, delivery, and insurance.

Pipe tobacco and roll-your-own tobacco: TTB has also seen a significant shift in the removals of pipe tobacco and roll-your-own tobacco post-CHIPRA. Under the IRC, pipe 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 to be smoked in a pipe. Roll-your-own tobacco is defined as 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 or cigars, or for use as wrappers of cigars or cigarettes. TTB's classification determination under the IRC depends on these factors at the point when a product is removed by the manufacturer or importer; subsequent actions by wholesalers, distributors, or retailers characterizing potential uses of these products are generally beyond TTB's jurisdiction.

Before CHIPRA, the tax rates on pipe tobacco and roll-your-own tobacco were the same (\$1.0969 per pound). CHIPRA increased the tax on pipe tobacco to \$2.8311 per pound, while the tax on roll-your-own tobacco was increased to \$24.78 per pound to make it generally equivalent to the cigarette tax. Because the two products can be similar (and even interchangeable), and because the tax on roll-your-own tobacco was significantly increased, a portion of the roll-your-own tobacco market has switched to pipe tobacco, resulting in a dramatic shift in the volume of pipe tobacco and roll-your-own tobacco reported as removed by domestic manufacturers. In the 12 months preceding CHIPRA, roll-your-own tobacco accounted for 86 percent of the combined roll-your-own and pipe tobacco market, with pipe tobacco representing the remaining 14 percent. Since CHIPRA (from April 2009 through calendar year 2013), there has been a near-complete reversal in these figures, with pipe tobacco accounting for 85 percent of combined roll-your-own and pipe tobacco removals and roll-your-own tobacco falling to 15 percent. TTB believes that this increase in pipe tobacco removals is partly due to increased consumer demand for pipe tobacco based on the price differential between pipe and roll-your-own tobacco (for use in a pipe or in a personal cigarette-making machine used at home), but it is exacerbated by the use of pipe tobacco in cigarette-making machines made available for commercial purposes (discussed in the following section). The growth in the hookah tobacco market, which is classified as pipe tobacco for IRC purposes, may also be a contributor.

In response to this shift, TTB published an advanced notice of proposed rulemaking in the Federal Register in July 2010 regarding potential physical characteristics of roll-your-own and

pipe tobacco that could be used to set an objective standard to differentiate between the products (75 FR 42659). The comment period was re-opened in 2011 to allow public comments on an additional proposal received from an industry member. Not only is it difficult to establish objective physical standards for differentiating between the two products, given the similarities and the wide variety among these products, it is also difficult to identify factors that differentiate pipe tobacco from roll-your-own tobacco for tax classification purposes, given the current statutory standards, as reflected by the comments received in response to the rulemaking.

Cigarette-making machines: The CHIPRA tax change coincided with technological advances in cigarette-making machines, some of which could make cigarettes from either pipe tobacco or roll-your-own tobacco at a much quicker rate, taking only eight minutes to “roll” or “fill” a carton (200 cigarettes) as compared to the three hours needed to “fill” a carton using older model machines. TTB believes that the CHIPRA increases to the tax on cigarettes and roll-your-own tobacco and the availability of a lower taxed alternative in the form of pipe tobacco resulted in an increase in the popularity of these machines. Some tobacco retailers and other machine operators attempted to rely on the “personal use” exemption to the definition of “manufacturer of tobacco products” to claim that the machines were being operated to produce products solely for personal consumption or use. The retailers sold cigarettes produced by cigarette-making machines at prices ranging from \$16.02 to \$25.50 per carton when the average price of a taxpaid, factory-made carton of cigarettes was about \$50 (excluding local taxes).

In response, on September 30, 2010, TTB issued Ruling 2010-4, Cigarette-Making Machines in Retail Establishments, which made clear that “the proprietor of a retail establishment who is in the business of making cigarettes for others, or who facilitates the making of cigarettes by or for others by providing the use of a commercial cigarette-making machine at its premises is engaged in the business of a tobacco products manufacturer and must qualify for and obtain a permit from TTB to engage in such business.” Beginning in November 2010, however, as part of a case filed by a cigarette-making machine company, a court restrained TTB from enforcing this ruling and issued an injunction in December 2010. TTB could not issue permits to retailers or other machine operators while this injunction was in place. In 2012, Congress passed a law, the Moving Ahead for Progress in the 21st Century Act, P.L. 112-141 (signed July 6, 2012) (“MAP-21”), that allowed TTB to take action by amending the definition of “manufacturer of tobacco

products” at 26 U.S.C. 5702(d) to specifically include “any person who for commercial purposes makes available for consumer use . . . a machine capable of making cigarettes, cigars, or other tobacco products,” which clarified that anyone making the machine available for commercial purposes must first obtain a permit to manufacture tobacco products from TTB and is liable for the resulting tax. The law became effective in July 2012, and the injunction was vacated shortly thereafter based on the clarification provided by MAP-21. In August 2012, TTB began processing permit applications for cigarette-making machine operators and actively enforcing the law against unpermitted machine operators.

TTB does not have authority to regulate the manufacture or distribution of these machines, so TTB cannot quantify the total number of cigarette-making machines currently in use, but TTB has obtained information from state authorities and other sources regarding the locations of cigarette-making machines. Based on this information, TTB has issued warning letters to 1,467 potential operators of cigarette-making machines since October 2012 to notify them of the civil and criminal liabilities associated with operating a cigarette-making machine for commercial purposes without obtaining a TTB permit and paying tobacco excise taxes.

TTB has also found that some cigarette-making machine operators claim to be a type of “social club” that has been established to make cigarette-making machines available to their “members.” These clubs do not have a TTB permit; however, some of them are registered with a state as “non-profit” or with IRS as “tax exempt” for income tax (not excise tax) purposes. The “social clubs” use this status to contend that they have a “noncommercial” purpose and are therefore exempt from federal excise tax. TTB issued public guidance in October 2012 to make clear that the non-profit status of the person or clubs making the machines available is not relevant in evaluating whether their purposes are “commercial.” Thus far, TTB has not concluded that any such operations are in fact exempt from excise tax liability or other IRC obligations, which TTB has reiterated in public guidance documents published in August 2013 and May 2014. Since 2013, TTB has initiated over 70 investigations involving these machines, the vast majority of which have involved “social clubs,” and has identified total tax liabilities of nearly \$4 million to date. TTB continues to investigate cigarette-making machine locations, including “social clubs,” with additional planned investigations for FY 2015.

Tobacco Diversion

In addition to the above issues, which generally involve tax avoidance by permitted industry members and others seeking to obtain a lower tax rate through the IRC framework, the 150 percent increase in the federal excise tax on cigarettes imposed by CHIPRA increased the incentive to evade federal taxes through tobacco diversion. Tobacco diversion refers broadly to the movement of tobacco products into domestic commerce without the payment of taxes. Accurately estimating tax losses resulting from tobacco diversion has inherent challenges, both because of the clandestine nature of the activity and the degree of underreporting in tobacco consumption data used to generate revenue loss estimates, as noted in the Department of the Treasury's 2010 Report to Congress. Common diversion schemes include the following:

- Tobacco products are removed from the manufacturer's premises in excess of the quantity reported to TTB, thus evading the tax on unreported quantities.
- Tobacco products are removed from the manufacturer's premises for export (which is a removal not subject to federal excise tax), and subsequently are diverted into domestic commerce before export, thus evading tax payment.
- Tobacco products are removed from the manufacturer's premises for export without tax, exported, and then smuggled back into the United States without the required importation entry and associated tax payment.
- Tobacco products are smuggled from abroad into the United States, disguised and declared as something other than as tobacco products, or are declared as a smaller quantity than actually imported, thus evading the applicable tax.
- Tobacco products are produced by a manufacturer operating without a permit and are removed for domestic consumption without the payment of applicable taxes.

TTB has seen each of these scenarios and addressed them through initiating criminal or civil proceedings, pursuing administrative remedies against TTB permittees, or working with state or other federal agencies to address unlawful conduct and collect the tax.

A vital component of our enforcement strategy, TTB's criminal enforcement program is critical to the bureau's ability to effectively curtail current illicit operations and deter others from engaging in diversion activity. Although still in its early stages, TTB's criminal enforcement

program has exhibited notable results in the less than four full years of operations since the program was initiated in FY 2011.⁶ With only a small cadre of special agents, obtained through an interagency agreement with the Internal Revenue Service Criminal Investigation Division, TTB has opened a total of 72 cases, with identified liabilities of over \$345 million in estimated alcohol and tobacco excise taxes and approximately \$117 million in criminal seizures. To date, 70 of 72 cases presented to the U.S. Attorney's Office have been accepted for further investigation – demonstrating both the merit and magnitude of these cases – and TTB has maintained a 100 percent conviction rate on cases fully resolved through the legal system. TTB's criminal enforcement program is also building key relationships with other federal and state law enforcement agencies, generating referrals for additional cases and opportunities for partnering in future cases and investigations.

In addition, specifically with regard to diversion risk associated with the importation and exportation of tobacco products, TTB has been working with CBP on cooperative enforcement efforts, including the development and implementation of the International Trade Data System (ITDS). The purpose of ITDS is to provide a “single window” through which importers and exporters will submit electronically all information necessary to comply with all other government agencies' requirements for the clearance of imports and exports. This cooperative system and the transactional trade data that it will provide are expected to factor prominently in TTB's tax enforcement strategy going forward. In addition to more timely and targeted information on imports and exports for TTB enforcement purposes, TTB expects that this effort will improve communication and coordination between CBP, TTB, and other participating agencies on tax and trade issues. TTB plans to be fully integrated into ITDS by November 2015, well in advance of the December 31, 2016 deadline for government-wide utilization of ITDS, as mandated by Executive Order 13659, entitled “Streamlining the Export/Import Process for America's Businesses.”

⁶Pursuant to the FY 2010 Consolidated Appropriations Act, TTB was appropriated \$3 million, expendable over two years, to hire, train, and equip special agents to enforce its criminal jurisdiction. Since FY 2012, TTB has been appropriated \$2 million annually to continue hiring special agents, which are now an important component of TTB's tobacco enforcement program.

Conclusion

I sincerely appreciate the opportunity to testify before the Committee today. I am proud of this bureau and what we have been able to accomplish in the 11 years since we were established in 2003. Despite our small size, we have worked to maximize the reach of our resources through the use of innovation, analytics, and partnering with other agencies to effectively exercise our jurisdiction over our regulated industries, collecting roughly \$23 billion in excise tax revenue in FY 2013, which represents a return of approximately \$450 for every dollar invested in TTB's revenue collection activities. As outlined above, tobacco-related enforcement issues continue to present distinct challenges for TTB and pose a risk to federal revenue post-CHIPRA, and these issues will likely exist as long as incentives remain under the IRC for manufacturers to reclassify products or restructure transactions to achieve a lower tax rate. Similarly, given the increased financial incentives for unlawful diversion following tobacco tax rate increases, illicit schemes to evade federal excise taxes will continue to evolve and require an ongoing and dedicated enforcement presence to address them. We are committed to using every tool available to detect and respond to illegal activity, including administrative, civil, and criminal remedies as well as coordination with other federal, state, and local authorities. I am honored to lead the fine women and men of TTB and proud of their dedication and resourcefulness in tackling these difficult challenges. I would be happy to discuss our tobacco tax enforcement activities and answer any questions you may have.