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March 26, 2007

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Alcohol and Tobacco Tax and Trade Bureau
Attn: Notice No.65
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Washington, DC 20044

RE: RIN 1513-AB 34/ Tax Classification of Cigars and Cigarettes (2006R-276P)

To Whom It May Concern:

Comments to TTB Notice No. 65, Tax Classification of Cigars and Cigarettes (2006R-276P) By the States of Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Montana, Nebraska, Nevada, New Hampshire, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia and Wisconsin.

Introduction

The States of Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Maryland, Michigan, Montana, Nebraska, Nevada, New Hampshire, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia and Wisconsin file the following comments on Notice No. 65, Tax Classification of Cigars and Cigarettes. Overall, the States applaud the TTB for its insightful and carefully-crafted proposed new rules classifying cigars and cigarettes for tax purposes.

The most recent statistics from the TTB show that small cigar¹ sales for 2006 are the highest ever reported in the United States.² Small cigar sales have increased 100% since 1999.³ While some portion of these sales are legitimate little cigars⁴, many are not. Rather, they are just brown cigarettes intentionally mislabeled as *Little Cigars*. This mischaracterization of cigarettes as *Little Cigars* is costing the federal government and the states millions of dollars in lost tax revenues.⁵ Finally, and more importantly, by mislabeling their brown cigarettes as some other tobacco product, the manufacturer evades the public health warnings and other health protections required for cigarettes.

The proposed new rules will help stem the tide of cigarettes mislabeled as *Little Cigars* or cigars to evade state cigarette and sales taxes and federal cigarette taxes, anti-smoking, and other public health protection laws. In the new rules, the TTB has addressed the most significant issues arising from this mislabeling while at the same time harmonizing the proposed new rules with the statutes, prior rulings, and current technology. The inclusion of objective criteria in the proposed new rules is consistent with the statutes and much easier for all concerned to understand and apply. Adopting both an objective, common-sense, appearance-based standard and a testing-based standard for classifying tobacco products allows the TTB to apply the best of both worlds to the tax classification determination.

In short, 39 States and the District of Columbia strongly support the regulations as proposed by TTB because they implement the rational and sound public health and tax policy of classifying and taxing as cigarettes any product that functions like a cigarette. We do, however, submit the following specific comments on the proposed new rules. Since the new proposed rules are consistent throughout the various parts of the Code of Federal Regulations, for ease of reference, these comments will refer to Part 40, but should be taken as applying equally to each similar proposed new rule in other parts of the Code of Federal Regulations.

40.11 Meaning of Terms

The TTB has proposed definitions for “substance containing tobacco” and “substance not

¹ “Small cigars” are defined by 27 C.F.R. § 40.11 as cigars weighing not more than three pounds per thousand.

² Statistical Report, Department of Treasury, Alcohol and Tobacco Tax and Trade Bureau, December 2006.

³ Id.

⁴ There are products that are small cigars that are in actuality cigars (i.e. a roll of tobacco wrapped in a tobacco leaf). In this comment, products that are actually cigarettes being sold as cigars will be referenced as “*Little Cigars*.” Products that are really little cigars will be referenced as “little cigars.”

⁵ If we assume the increase in small cigar sales since 1999 is attributable to products that are really cigarettes, the federal government has lost \$43,133,076.00 in tax revenues on those sales.

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containing tobacco” which are used in the proposed regulations to describe the wrapper of the tobacco product to be classified. Both of those definitions refer to a percentage of tobacco leaf or other fibrous material from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*. Yet it is not clear from the proposed new rules how the TTB will determine if a reconstituted tobacco sheet is at least (or less than) two-thirds by weight tobacco leaf or other fibrous material from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*.

The States believe, moreover, that the tobacco in the wrapper should also be tested together with the filler to determine if the product contains more than 3.0 percent by weight of total reducing sugars, and thus is a cigarette. The States have been informed that some unscrupulous manufacturers put the cigarette tobaccos in the wrapper with the intent to evade detection if only the filler tobacco is analyzed.

In addition, the TTB has proposed not carrying forward the following language from ATF Ruling 73-22 in the definition of “substance containing tobacco”:
For a wrapper material to be considered a "substitute [sic: should be substance] containing tobacco" as used in 26 U.S.C. 5702(a), the finished wrapper must (1) be approximately two-thirds or more tobacco which did not in the reconstitution process lose its tobacco character (e.g., taste, aroma, identifiable chemical components), and (2) be of a color consistent with that of the natural leaf tobaccos traditionally used as a wrapper for American cigars.⁶

This language is consistent with ATF Procedure 73-5 which discussed the fact that prior to 1959 cigars in the United States were made with a wrapper of natural tobacco leaf. However, by the late 1950's researchers produced several types of reconstituted tobacco sheet. Many of these sheets were submitted to the TTB with a request that they be accepted as wrappers for cigars. The TTB “found that several of these reconstituted or ‘homogenized’ tobacco materials did possess most of the essential characteristics of natural leaf tobacco then in use as cigar wrappers.”⁷ In 1965 Congress specifically recognized that reconstituted tobacco could be a wrapper for cigars when it enacted Public Law 89-44. “In so doing Congress continued the principles of administration that acceptable wrapper materials for cigars must possess the basic characteristics of tobacco and the filler tobaccos must not be like those used in cigarettes.”⁸

The States believe that this concept is important and should be carried forward in the definition of “substance containing tobacco.” The key phrase “which did not in the reconstitution process lose its tobacco character (e.g., taste, aroma, identifiable chemical components)” allows the TTB to examine and test the wrapper and binder material as well as the filler material. This is important to assure that the wrapper or binder are not used as vehicles to introduce sugars or cigarette tobacco (with its naturally high sugar

⁶ ATF Ruling 73-22.

⁷ ATF Procedure 73-5.

⁸ Id.

content) into a product that is denominated a cigar. The TTB should retain its wrapper and binder examination and testing standards but should also clarify that a product will be classified and taxed as a cigarette if the product has a wrapper and binder that “yields the smoking characteristics” inconsistent with natural leaf tobacco. The omission of this language will allow unscrupulous tobacco product manufacturers to evade the new proposed rules by simply adding sugars, flavorings or cigarette-type tobaccos to the wrapper, not the filler. In addition, the color of the wrapper is a matter of appearance that can cause the product to be “offered to or purchased by consumers as a cigarette.” To the average consumer, the color of the wrapper is far more important than the chemical composition of the wrapper in determining whether a product is a cigar or a cigarette. The average consumer does not know, or care, if the wrapper is made of reconstituted tobacco or paper, they simply look at the color of the product.

For all these reasons, the States urge the TTB to retain the wrapper examination and testing standards as set forth in Section 4 of ATF Procedure 73-5, and repeated on page 62508 of Notice No. 65. The wrapper examinations and tests should be retained in the new proposed rulemaking but the reducing sugars test as set forth in Notice No. 66 should be substituted for the sequential differential solvent extractions test as described in Section 7.08. The 3% by weight of total reducing sugars test should be applicable to the tobacco in the wrapper and binder as well as the filler of the roll of tobacco. The TTB should include language that a product with a wrapper or binder that yields smoking characteristics inconsistent with natural leaf tobacco will be classified and taxed as a cigarette.

40.12 Classification of Cigars and Cigarettes.

(a)(1) and (2) Cigar Classification

The States believe that the TTB has done an admirable job of defining cigars in proposed new rule 40.12(a)(1) and (2). It is clear that 26 U.S.C. § 5702(a) requires a roll of tobacco wrapped in leaf tobacco to be a taxed as a cigar. It is also clear that 26 U.S.C. § 5702(a) allows a roll of tobacco wrapped in substance containing tobacco to be a cigar only if it is not a cigarette. Therefore, the TTB’s proposed new rule 40.12(a)(2) which gives precedence to the definition of cigarette is a correct and proper statement of the law.

(b)(1) Cigarette Classification

Proposed new rule 40.12(b)(1) captures the statutory intent of 26 U.S.C. § 5702 while providing clear and workable guidelines for tobacco product manufacturers. The TTB has retained the statutory language that a product wrapped in paper or in any substance not containing tobacco is a cigarette. This is undisputable. It is consistent with 26 U.S.C. § 5702 as well as past practice of the TTB that any product wrapped in paper or in some substance other than tobacco (i.e., a bidi) is a cigarette.

(b)(2) A New Testing Standard

The TTB's new testing standard in 40.12(b)(2) is a workable testing standard which will be much faster to conduct and readily applied by all entities who deal with issue including manufacturers and states, as well as the TTB.

(b)(3) Common Sense, Objective Appearance-Based Classification Criteria

Proposed new rule 40.12(b)(3)(ii) sets forth common sense, objective appearance-based factors that will result in a product being classified as a cigarette using only the naked eye. The criteria are based on traditional tobacco industry custom and practices with regard to the size and shape of the product, the use of an integrated filter, and the product packaging.

Size and Shape. First, the rule states that a product that is the size and shape of a typical cigarette will be considered a cigarette. After all, when the dimensions and form of the product are those of a cigarette, they will cause the average consumer to perceive and purchase the product as a cigarette--not a cigar. A casual glance at a product that is as thick as the cork in a wine bottle would tell the average consumer it is a cigar. But a product that is the much smaller, slender shape and pencil-like size of cigarette appears, of course, to be a cigarette.

Integrated Filter. The second aspect of appearance that makes a cigarette unique is the integrated filter. The TTB has correctly determined that the integrated filter is unique to cigarettes. There is no need for an integrated filter on a cigar. Cigars are not intended to be inhaled. In fact, the very essence of cigar smoking is **not** to inhale the product. Cigarettes alone are intended to be inhaled, and hence they need an integrated filter to protect the smoker from inhaling bits of tobacco and hot ash as well as harmful chemicals from the filler. In this single proposed rule, the TTB has captured one of the most meaningful and important distinctions between the appearance of a cigarette and a cigar.

Packaging. The third subsection of the rule, however, should be amended to read, "or is put up in a traditional cigarette-type package ~~that does not bear all the notice requirements for cigars specified in § 41.73.~~" Tobacco product manufacturers who place their product into a traditional cigarette-type package do so for one reason--to make them appear to be cigarettes. Many of the *Little Cigars* on the market today are labeled as little cigars on the package. But the average consumer sees a product that looks like a pack of cigarettes and views it as a pack of cigarettes--regardless of how it is labeled. Labeling has been used by unscrupulous manufacturers to take a product that is purposely designed to look like a cigarette and deny that it is, in fact, a cigarette. The packaging of the product is critical in how the average consumer perceives the product. The labeling of these products is largely superfluous. The average consumer relies on the shape and size of the product, its appearance (including whether it is filtered), and the packaging to determine if the product is a cigar or a cigarette. To suggest that the average consumer will not think a product that looks like a cigarette and is placed in a cigarette-type

package is a cigarette if it is labeled as a cigar is to deny reality. The TTB should recognize that, in this area in particular, the average consumer relies on the appearance of the product. Therefore the proposed new rule should state that any product placed into a traditional cigarette-type package is a cigarette even if it is labeled as a little cigar.

Objective Lab Test-Based Classification Criteria

New proposed rule 40.12(b)(3)(iii) is a restatement and codification of ATF Ruling 73-22. The newly proposed rule addresses the filler of the tobacco product. Flue-cured, oriental or burley tobaccos are traditionally cigarette fillers. Cigars are traditionally made with fermented tobaccos. The new proposed rule classifies products as cigarettes if they have fillers primarily consisting of flue-cured, oriental, burley, or unfermented tobaccos. This is an appropriate statement of the traditional difference between filler tobaccos in cigars and cigarettes.

The TTB has proposed a new rule that not only addresses the type of tobacco used in the filler but also filler that “yields the smoking characteristics of” a cigarette. This is a rule intended to prevent a manufacturer from using cigar tobaccos that have been altered by the addition of products or chemicals to yield a cigarette-type smoking experience. Here the TTB has anticipated the ability of manufacturers to alter their product with the addition of chemicals that will turn cigar tobacco into a cigarette-tobacco smoking experience. The TTB has acted with great regulatory foresight to prevent manufacturers from making an end run around the new proposed rules.

40.13 Cigar Certification

The new certification requirement for cigars should be applied to all products that a manufacturer wants to have taxed as cigars, even if the products fall under the “roll of tobacco wrapped in leaf tobacco” section of the definition not just the “roll of tobacco wrapped in a substance containing tobacco” section of the definition. The burden should be on the tobacco product manufacturer not only to determine the tax classification of the product but also to provide evidence of the proper tax classification to the TTB. The certification requirement should be expanded to include a requirement that a manufacturer provide a copy of the analysis of its product from an accredited lab showing that the product contains no more than 3% by weight total reducing sugars, and samples of the product and packaging in order to ensure that the product does not fall within the “looks like a cigarette” portion of the definition found in 40.12(b)(3)(ii) or the “smokes like a cigarette” portion of the proposed new rules found in 40.12(b)(3)(iii). The lab should be specifically accredited to perform the Total Reducing Sugars Analytical Method specified in TTB regulations. Finally, the term “presentation” as used in the proposed cigar certification rule should be defined to include all packaging and advertising material, including point of sale advertising.

40.214 Notice for Cigars

For the reasons set forth above the States do not support allowing manufacturers to sell brown cigarettes in traditional cigarette-type packages if they mislabel them as little cigars to evade state and federal taxes and public health protections. Mislabeling should not be allowed to be a self-serving, self-issued license to evade taxes, nor more importantly, to sell brown cigarettes without the health warnings, advertising prohibitions, youth access, and other public health protections that apply to cigarettes. Some smokers, especially our youth, may assume mistakenly that the brown cigarettes, mislabeled as little cigars, are a safer alternative to smoking because the packages lack the required cigarette health warnings.

Publication of Tax Classifications of Rolls of Tobacco Wrapped in Reconstituted Tobacco

Since rolls of tobacco wrapped in reconstituted tobacco can be either a cigar or a cigarette for tax purposes, the States have a legitimate interest in knowing the tax classification of the product. 27 CFR § 70.802(f) makes the tax classification of rolls of tobacco wrapped in reconstituted tobacco publicly available upon written request. The regulation requires the requestor to submit the brand name of the product and the name and address of the manufacturer or importer to the appropriate TTB official. However, State investigators do not necessarily know the name and address of the manufacturer or importer when they find packs of contraband cigarettes. Since TTB regulations allow tobacco products to be marked with a trade name, permit number or manufacturer name, and some other mark, any of those designations may appear on tobacco product packages, but neither the address of the manufacturer nor that of the importer is required.⁹ Nor is it unusual to see tobacco products marked with a manufacturer's name and address different than that of the holder of the permit listed on the product.

While TTB regulations also allow any interested party to request the true identity of a company authorized to use a trade name, this two-step process is cumbersome and time consuming.¹⁰ As part of its new rulemaking on cigars and cigarettes, the TTB should streamline this process by publishing on its website a list of these products by brand and manufacturer's name and address. The interested public could then submit a query as to the tax classification of the product by clicking on the brand and manufacturers' name and address. This would allow the States, and interested members of the public, to determine the tax classification of a product without having to first request the true identity of the company using a trade name in order to determine the manufacturer of a tobacco product, and only then to submit a second written request for the tax classification of the product. If the TTB does not wish to maintain the data in publicly available list form, e-mail requests for trade names and tax classifications should be accepted as written requests pursuant to 27 CFR § 70.802 (e) and (f).

⁹ See 27 CFR § 40.212.

¹⁰ See 27 CFR § 70.802(e).

It should be noted that the States are merely requesting that the TTB publish data that is already public information. It lessens the administrative burden on the agency to publish data that is public rather than responding to repeated individual requests for the same data. The Federal Trade Commission publishes lists of approved cigarette health warning labels by company name and address and brand. The TTB should do the same with the tax classification of rolls of tobacco wrapped in reconstituted tobacco.

Conclusion

Overall, the States believe that in these proposed rules the TTB has done an admirable job of addressing the most significant issues posed by *Little Cigars* or cigars that are, in reality, cigarettes. The States stand in support of the proposed rules as drafted, but they believe the minor comments or amendments above will make the proposed rules, which are already very good, even better. Through these comments, the States join with TTB to craft a new, clear, common-sense regulatory structure that prevents tax evasion and better protects the health of our citizens, especially our youth.



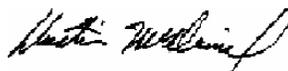
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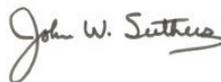
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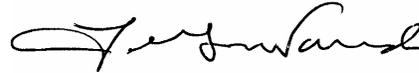
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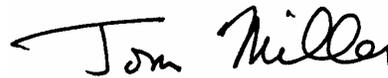
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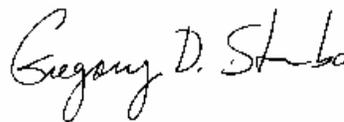
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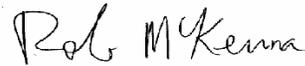
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