



INDUSTRY CIRCULAR

DEPARTMENT OF
THE TREASURY

Bureau of Alcohol, Tobacco and Firearms
Washington, D. C. 20226

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LARGE CIGAR TAXES ON AND AFTER JANUARY, 1991

Tobacco Products Manufacturers, Export Warehouse Proprietors and Others Concerned.

Purpose. This Industry Circular is to inform you of a Treasury decision, recently published in the FEDERAL REGISTER, which amends 27 C.F.R. Parts 270 and 275 to comply with the provisions of the Omnibus Budget Reconciliation Act of 1990 (Public Law 101-508, 104 Stat. 1388) concerning the Federal excise taxation of large cigars. This circular responds to various questions which have been raised concerning ATF's implementation of the amended law and the regulations.

Increase in Federal Excise Tax Rates and Modification of Tax Calculation. Public Law 101-508, 104 Stat. 1388, enacted on November 5, 1990, modified the method for calculating the excise tax on large cigars and increased the tax rate for taxpaid or tax-determined removals from internal revenue or customs bond on or after January 1, 1991. Prior to January 1, 1991, the excise tax on large cigars was calculated on the wholesale price. Under the amended law, the tax on large cigars is based on the price for which the cigars are sold by the manufacturer or importer (the actual sale price), rather than the wholesale price. In effect, large cigars with a sale price of \$235.294 per thousand or less are taxed at the rate of 10.625% of the sale price during 1991 and 1992, and at the rate of 12.75% of the sale price in 1993 and thereafter. Large cigars with a sale price of more than \$235.294 per thousand are taxed at the maximum rate of \$25 per thousand during 1991 and 1992, and at the maximum rate of \$30 per thousand in 1993 and thereafter. Outlined below are some of the common questions asked about the revised taxation of large cigars.

1. How is the sale price determined? The regulations provide that rules similar to 26 U.S.C. § 4216(a) and the regulations issued thereunder will apply in determining "price." The "price" for which cigars are sold includes the total consideration for the cigars in the form of money, services, or other things. Any charge which is made incident to placing the cigars in condition ready for use is included in the sale price. That is, any charge which is required by a manufacturer or importer to be paid as a condition of its sale of the cigars (and which is not attributable to an expense falling within one of the exclusions described below) is includible in the taxable sale price. It is immaterial that the charge may be paid to a person other than the manufacturer or importer, or that it may be separately billed to the purchaser as a charge earmarked for expenses incurred or to be incurred on the purchaser's behalf.

Any charge by the manufacturer or importer for coverings and containers of whatever nature used to pack an article for shipment shall be included as part of the sale price for the purpose of computing the tax, whether or not the charges are identified as such on the invoice or billed separately. Additionally, where a cigar and a nontaxable article are sold as a unit by the manufacturer or importer, the tax attaches to that portion of the sale price of the unit which is properly allocable to the cigar.

Exclusions from the sale price include the following items:

Federal excise tax as imposed under 26 U.S.C. §§ 5701 and 7652.

Any retail sales tax imposed by a State or political subdivision thereof or the District of Columbia if stated as a separate charge, whether the liability for such tax is imposed on the vendor or vendee.

Actual expenses of charges incurred for transportation, delivery, insurance, and other expenses in connection with the delivery of cigars to a purchaser pursuant to a bona fide sale shall be excluded from the sale price in computing the tax. Such charges include all items of transportation, delivery, insurance, and similar expense incurred after shipment to a customer begins, in response to the customer's order, pursuant to a bona fide sale. However, costs of such nature incurred by a manufacturer or importer in transporting, in the normal course of business and for its benefit and convenience, cigars from a factory or port of entry to a warehouse or other facility are not considered as being incurred in connection with the delivery of cigars to a purchaser pursuant to a bona fide sale, and charges therefor cannot be excluded from the sale price. Any allowance granted by a manufacturer or importer as reimbursement for expenses incurred by the purchaser in shipping cigars withdrawn from the market to the manufacturer or importer for credit against the purchase price of other cigars shall not be excluded from the sale price when computing the tax.

A charge or expense not within the scope of the above described items, whether or not separately stated, may not be excluded in computing the taxable sale price unless it can be shown that the charge or expense is not properly to be included as a manufacturing, importing or selling expense or is in no way incidental to placing the cigar in condition packed ready for shipment.

2. How are free cigars or discounts on the price of cigars treated for excise tax purposes? Free cigars, that is, cigars given away by the manufacturer or importer, are not subject to any excise tax since no sale occurs that results in a price. Discounts affect the price on which the tax is based. For example, if a box of 100 cigars, each of which were normally sold by the manufacturer or importer at \$1, was discounted by 10%, then the tax (in 1991) would be calculated at 10.625% of \$90, resulting in a tax of \$9.56.

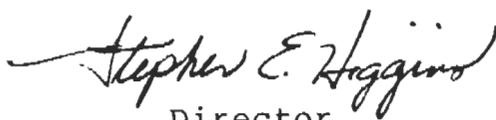
3. How is the sale price determined for purposes of the excise tax on imported cigars released from customs custody and held at a domestic warehouse before sale? The tax liability on imported cigars is due when the cigars are removed from customs custody. However, in many cases, this removal occurs before the sale of the cigars, since the cigars are shipped to a warehouse pending sale. In these situations, the excise tax due at the time of removal from customs custody is calculated upon the importer's posted general price of the cigar. The manufacturer or importer will, if necessary, make a later adjustment based on the actual sale price by either paying an additional amount of tax (with interest) or filing a claim for refund or credit (with interest).

4. How is the sale price determined for calculating the tax on cigars brought into the United States from Puerto Rico, since the tax is pre-paid in Puerto Rico? If the cigars are brought into the United States for warehousing prior to their sale, then the tax on these cigars is paid in Puerto Rico at a rate calculated upon the general price of the cigars posted by the person bringing the cigars into the United States for warehousing prior to their sale. Similar to imported cigars, the taxpayer will make any necessary adjustments after the actual sale of the cigars. Alternatively, if the cigars are brought into the United States as part of a sales transaction between affiliated corporations, then the constructive sale price rules discussed in question 5, below, may apply to these sales transactions in order to determine the price for excise tax purposes.

5. When do the constructive sale price rules of 26 U.S.C. § 4216(b) apply to determining the sale price? Section 5702(m) or Title 26, U.S.C., as amended by Public Law 101-508, applies the rules of section 4216(b) in determining the price of cigars. These constructive sale price rules apply to cigars sold by a manufacturer or importer at retail, sold on consignment, or sold (otherwise than through an arm's length transaction) at less than the fair market price. Sales of cigars between affiliated corporations may be analyzed under the constructive sale price rules. In these situations, ATF will be guided by the provisions of section 4216(b) and the rules promulgated in the regulations at 26 C.F.R. § 48.4216(b)-1 through 4, in determining the sale price for purposes of the tax computation.

6. How does the new method of tax calculation on large cigars affect the refund or credit of tax on such cigars withdrawn from the market? The procedures under the current regulations still apply. The burden of proof is on the claimant for the amount of tax to be refunded or credited on claims for large cigars withdrawn from the market. Absent documentation satisfactory to the regional director (compliance) for the amount of tax actually paid on the cigars, the refund or credit of tax is limited under 27 C.F.R. § 270.311(b) to the minimum amount applicable to that brand and size of cigar during the three (3) year period required for record retention under 27 C.F.R. § 270.185.

Inquiries. If you have any questions refer to this circular by number and contact the Regional Director (Compliance) for the region in which you are located.


Director