



OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 1, 2014

OIG-14-CA-013

MEMORANDUM FOR JOHN J. MANFREDA, ADMINISTRATOR
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

FROM: Marla A. Freedman /s/
Assistant Inspector General for Audit

SUBJECT: Termination Memorandum – Audit of TTB Actions Taken
Over Cigarette Excise Tax Losses

On December 6, 2011, we initiated the subject audit at the Alcohol and Tobacco Tax and Trade Bureau (TTB). The overall audit objective was to identify and assess the actions taken by TTB in response to the February 4, 2010, report titled *Department of the Treasury Report to Congress on Federal Tobacco Receipts Lost Due to Illicit Trade and Recommendations for Increased Enforcement* (Treasury's 2010 report). This study was required by the Children's Health Insurance Program Reauthorization Act of 2009 (CHIPRA), which increased the Federal excise tax on cigarettes and other tobacco products. For the reasons discussed below and in consideration of the current workload of our office, we are terminating this audit.

We noted that Treasury's 2010 report focused on the manufacturing and importation of cigarettes, which represented the majority of the Federal excise tax collected annually by TTB on tobacco products. Treasury reported on potential Federal excise tax losses based on estimates of the number of cigarettes consumed annually. The Federal excise tax loss estimates, however, were inconclusive because reliable data on cigarette consumption was not available.

Notwithstanding this, TTB used the results from the Treasury's 2010 report in its 2010 and 2011 annual reports stating that Federal excise tax losses from illicit cigarette trade ranged from \$500 million to \$1.5 billion and could be as high as \$4.5 billion when the CHIPRA tax rate increase was considered. TTB again cited the Treasury's 2010 report in its 2012 annual report stating that despite the difficulty of estimating tax losses, Treasury's 2010 report estimated

that tax receipts were diminished by as much as \$1.5 billion annually from 2005 to 2007 due to illicit activity. In its 2013 annual report, TTB no longer provided dollar estimates of Federal excise tax losses based on Treasury's 2010 report. In that document, TTB discussed the clandestine nature of illicit tobacco and alcohol trade in general and the difficulty of accurately measuring Federal tax lost from alcohol and tobacco diversion. Based on our understanding of the inconclusive nature of the loss estimates in Treasury's 2010 report, we agree with TTB's decision not to discuss specific loss estimates in its 2013 annual report.

The recommendations included in the Treasury 2010 report provided for enhanced coordination between Treasury and the Department of Health and Human Services in the oversight of tobacco matters and for additional resources and authority be provided to TTB in its efforts to combat illicit tobacco trade. During our audit, we were told that TTB was implementing other actions focused on increased enforcement to identify Federal excise tax due, including developing specialized audit teams and risk assessment models, using the services of Internal Revenue Service special agents to pursue criminal cases, and enhancing cooperation and data sharing with the U.S. Department of Homeland Security's Customs and Border Protection. At this time, we believe it is too early for us to assess the impact of these efforts on combatting illicit tobacco trade to reduce Federal excise tax losses.

In conclusion, we believe that issuing a report based on inconclusive tobacco Federal excise tax loss estimates or prior to when we can appropriately evaluate the results of TTB's other enforcement initiatives would not provide a benefit to TTB. Accordingly, we are terminating this audit. We plan to include an audit of TTB's enforcement initiatives in the Office of Inspector General 2015 Annual Plan.

Should you have any questions, please contact me at (202) 927-5400 or Sharon Torosian, Director, at (617) 223-8640.

cc: Timothy Skud, Deputy Assistant Secretary for Tax, Trade, and Tariff Policy
Timothy Marsh, Deputy Director, Criminal Enforcement, Office of Assistant Administrator, Field Operations, TTB