

## DETERMINATION OF RETAIL PRICE FOR PURPOSES OF EXCISE TAX ON CIGARS

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Mr. BYRD of Virginia, from the Committee on Finance, submitted  
the following

### R E P O R T

[To accompany H.R. 10960]

The Committee on Finance, to whom was referred the bill (H.R. 10960) to amend section 5701 of the Internal Revenue Code of 1954 with respect to the excise tax upon cigars, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

#### I. SUMMARY OF BILL

The Federal excise tax on large cigars is paid by the manufacturer but based on the intended retail price of the cigars. Seven different tax brackets provide tax rates increasing with the intended retail price of the cigar. This intended retail price of the cigar is determined in the principal market of the cigar, or the locality where most of a particular brand is sold. Under present law this price is determined by excluding State and local *retail* sales taxes from the price. Under this bill the price is determined by excluding "any State or local taxes imposed on cigars as a commodity." This excludes not only retail sales taxes but taxes such as manufacturers and wholesalers sales taxes in determining the intended retail price of large cigars. This amendment is to apply to cigars removed on or after the ninth day of the first month beginning after the date of enactment of this bill.

The Treasury Department favors the enactment of this bill.

#### II. GENERAL STATEMENT

Under present law (sec. 5701(b)(2)) the tax on large cigars (those weighing more than 3 pounds per thousand) begins at \$2.50 per thousand for those intended to retail at not more than 2½ cents, and in seven tax brackets increases to \$20 per thousand for those intended to retail at more than 20 cents each. In determining the retail price

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at which cigars are sold for purposes of these seven tax categories, present law states that "regard shall be had to the ordinary retail price of a single cigar in its principal market, exclusive of any State or local taxes imposed on the retail sale of cigars." The principal market of a cigar, according to Treasury Department interpretation (Rev. Rul. 55-20, C.B. 1955-1, p. 516), is the locality in which the bulk of such cigars are sold singly at retail.

As indicated above, the ordinary retail price of a single cigar in its principal market is to be determined by excluding any retail State or local taxes imposed on the sale of the cigar in its principal market. However, the Treasury Department in connection with a Minnesota statute imposing a 15-percent tax (now 20 percent) on the wholesale price of certain tobacco products, including cigars, has ruled that the price which determines the Federal tax category is not to exclude any State or local wholesale or manufacturer tax imposed on cigars (Rev. Rul. 55-698, C.B. 1955-2, p. 474).

The problem which has been called to the attention of your committee involves a 20-percent Michigan wholesale tax on cigars. It is understood that one manufacturer located in Michigan produces a cigar intended to retail at 15 cents exclusive of State or local taxes. However, as a result of the Michigan wholesale tax of 20 percent, the cigars now sell at retail in Michigan for more than 15 cents (including tax). Moreover, Michigan is the principal market in this case. Under present law the Federal cigar tax is \$10 per thousand for cigars selling at retail for more than 8 cents but not more than 15 cents and is \$15 per thousand for those in the category above 15 cents but not above 20 cents. As a result, in the case in question the Michigan wholesale tax in effect has increased the Federal tax from \$10 to \$15 per thousand. However, manufacturers of competing cigars, also intended for sale at 15 cents exclusive of State or local taxes, can be sold in Michigan and elsewhere without the payment of the additional Federal tax of \$5 per thousand if their principal market is in an area where there is no State or local wholesale tax.

Your committee does not believe that differences in State or local taxes on cigars in general should make a difference in the Federal rate of taxation for cigars. To permit such taxes to be taken into account creates an artificial distinction among various cigars and leads to competitive discrimination.

For the reasons given above, your committee has amended the code (sec. 5701(b)(2)) to provide that in determining the retail price for tax purposes regard is to be had for the ordinary retail price of a single cigar in its principal market, exclusive of any State or local taxes imposed on cigars as a commodity, whether they are taxes on the wholesale, retail, or manufacturers' price. However, this is not intended to provide any exclusion for taxes such as those on gross receipts, income, or personal property.

This provision is to be effective with respect to cigars removed from the factory or released from customs custody on or after the ninth day of the first month which begins after the date of enactment of this bill.

The Treasury Department has indicated that while some revenue will be lost as a result of preventing certain cigars from being forced into higher tax brackets as a result of State wholesale taxes, it does not believe that this result was the intent of Congress and, therefore,

does not believe that this should be considered as a revenue loss in the usual sense in which this term is used.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italic; existing law in which no is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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SEC. 5701. RATE OF TAX.

(a) TOBACCO.—On tobacco, manufactured in or imported into the United States, there shall be imposed a tax of 10 cents per pound.

(b) CIGARS.—On cigars, manufactured in or imported into the United States, there shall be imposed the following taxes:

(1) SMALL CIGARS.—On cigars, weighing not more than 3 pounds per thousand, 75 cents per thousand;

(2) LARGE CIGARS.—On cigars, weighing more than 3 pounds per thousand:

(A) If removed to retail at not more than 2½ cents each, \$2.50 per thousand;

(B) If removed to retail at more than 2½ cents each and not more than 4 cents each, \$3 per thousand;

(C) If removed to retail at more than 4 cents each and not more than 6 cents each, \$4 per thousand;

(D) If removed to retail at more than 6 cents each, and not more than 8 cents each, \$7 per thousand;

(E) If removed to retail at more than 8 cents each and not more than 15 cents each, \$10 per thousand;

(F) If removed to retail at more than 15 cents each and not more than 20 cents each, \$15 per thousand;

(G) If removed to retail at more than 20 cents each, \$20 per thousand.

In determining the retail price, for tax purposes, regard shall be had to the ordinary retail price of a single cigar in its principal market, exclusive of any State or local taxes imposed on [the retail sale of cigars] *cigars as a commodity*. Cigars not exempt from tax under this chapter which are removed but not intended for sale shall be taxed at the same rate as similar cigars removed for sale.