



EXECUTIVE SUMMARY
Department of Revenue and Taxation Tobacco Tax
OPA Report No. 18-04, May 2018

Pursuant to Title 11, Guam Code Annotated (GCA) Chapter 26 Article 6, tobacco tax collections are supposed to be immediate because tobacco imports are released after tax payments are made. However, 99% of tobacco taxes are not collected immediately because the law allows importers (tobacco wholesalers) to delay tax payments on tobacco products it stores in private warehouses, when authorized by the Department of Revenue and Taxation (DRT). We did not receive sufficient evidence to independently verify whether the tobacco taxes reported to DRT for fiscal year (FY) 2013 through FY 2016 corresponded with imports of tobacco products.

Tobacco tax legislation allows DRT to know how much tax should be reported and paid, unlike other self-reported business privilege taxes (BPT). However, the Guam Customs and Quarantine Agency (CQA) and DRT's policies and procedures for assessing tobacco tax provide opportunities for underreporting and fall short of ensuring that all tobacco taxes are paid. Specifically, we found:

- DRT's data on the number of Guam-licensed tobacco wholesalers did not match the number of taxpayers filing tobacco tax;
- CQA does not maintain comprehensive, detailed data on imported tobacco products;
- Tax receivables and deferred revenues are not recorded for the imported tobacco products stored in the DRT-controlled section of the wholesaler's warehouse;
- DRT and CQA do not reconcile the tobacco taxes reported to the tobacco shipments;
- Guam Tobacco Deposit (GTD) forms at CQA did not have the updated tax rates; and
- Variances between taxes paid and our calculations for tax due for what appears to be an underpayment of \$142 thousand (K) by one taxpayer and overpayments ranging from \$2K to \$46K by three taxpayers.

The Government of Guam (GovGuam) receives approximately \$20 million (M) annually from tobacco tax revenues, which are dedicated to specific programs focused on health, prevention and treatment of addiction, cancer outreach, and the Guam Memorial Hospital Authority.

Insufficient Data to Verify Taxes to Imports

We attempted to obtain data on the quantity of tobacco (i.e., cigarettes, cigars, and other tobacco products) imported to Guam via the tobacco manufacturers/distributors conducting business with Guam-licensed tobacco wholesalers. However, not all Guam-licensed tobacco wholesalers, nor the tobacco manufacturers/distributors they import from, were responsive to our inquiries.

Tax Receivables and Deferred Revenues Not Recorded for Authorized Wholesalers

In light of GovGuam's ongoing cash constraints, any improvements to government revenue collections are welcome. Pursuant to legislation, tobacco tax is charged and collected when the products are discharged from its carrier. However, only 1% of imported tobacco was taxed and collected upfront by CQA because the law allowed five wholesalers authorized by DRT to delay tax payments on the tobacco stored in a "warehouse under bond." Essentially, a "warehouse under bond" is a private warehouse with a separate area controlled by DRT with padlock keys under

DRT's custody. While access to the tobacco appeared to be limited to when a DRT representative was present for the delivery and withdrawal, we could not verify that DRT had sole custody of all the keys to each padlock.

Upon initial delivery of the tobacco to the warehouse, a DRT representative verifies the quantities stored in the warehouse to the invoice/bill of lading attached to the Tracer of Product form (tracer), but DRT makes no detailed record in its books, such as potential tax receivable. When the wholesaler is ready to withdraw the tobacco, a DRT representative is contacted to unlock the separated area and verify the quantities withdrawn. Similarly, DRT makes no detailed record in its books, such as deferred tax revenue. In addition, DRT does not reconcile the wholesaler's tax filing with the quantities and weights of the tobacco withdrawn from these warehouses. Unlike other taxable products, DRT can physically inspect taxable tobacco products and know how much tobacco tax should be collected for GovGuam. Essentially, DRT has been reliant on the wholesalers' voluntary compliance and self-reporting of tobacco taxes, like other BPTs.

Variance Between Tax Paid and Tax Owed

An analysis of DRT's data on tobacco tax paid and our calculations for tax due identified what appears to be an underpayment of \$142 thousand (K) by one taxpayer and overpayments ranging from \$2K to \$46K by three taxpayers. While not conclusive, we referred to DRT for further review.

Introduction of the Cigarette Tax Stamp

Tax assessment on cigarettes will change with the enactment of Public Law (P.L.) 34-55, which introduced the cigarette tax stamp, expected to go into effect no later than October 2018. Though the intent of the tax stamp was to establish a system to improve tobacco tax collections, P.L. 34-55 allows the tobacco wholesaler to pay for the tax stamps in the following month *after* the stamps were purchased. Unless DRT is to reconcile, the tax stamp may be like other BPTs.

Other Matters

In July 2015, a CQA officer pled guilty in the U.S. District Court of Guam to having accepted bribes from a business owner between approximately 2010 and 2015 in exchange for releasing shipping containers without collecting taxes for the cigarettes contained therein.

Conclusion and Management Response

Due to constraints in obtaining sufficient evidence for independent verification, we referred concerns of potential underreporting to DRT to further investigate. We also made three recommendations to improve the management of tobacco taxes. In DRT's management response, the Director generally disagreed with the findings and recommendations, and specifically contested our finding that tax receivables and deferred revenues should be recorded for imported tobacco products stored in the DRT-controlled section of the wholesaler's warehouse. The DRT Director indicated that they will discuss with DOA the advantages and disadvantages for accrual accounting. DRT is also of the position that it "has been effective in administering the tobacco tax laws of Guam... DRT continues to identify ways to improve Information Technology to reduce manual processes... DRT is committed to ensuring that the proper taxes are paid and those who are noncompliant are identified and penalized to the full extent of the law."

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