

DEPARTMENT OF THE TREASURY**Alcohol and Tobacco Tax and Trade Bureau****27 CFR Parts 40, 41, 44, and 45**

[Notice No. 65]

RIN 1513-AB34

Tax Classification of Cigars and Cigarettes (2006R-276P)**AGENCY:** Alcohol and Tobacco Tax and Trade Bureau, Treasury.**ACTION:** Notice of proposed rulemaking.

SUMMARY: The Department of the Treasury and the Alcohol and Tobacco Tax and Trade Bureau are proposing changes to the regulations that govern the classification and labeling of cigars and cigarettes for Federal excise tax purposes under the Internal Revenue Code of 1986. The proposed regulatory changes contained in this document address concerns that TTB has regarding the adequacy of the current regulatory standards for distinguishing between cigars and cigarettes. The document also summarizes and responds to three petitions received by TTB requesting rulemaking action regarding the classification of cigars and cigarettes, with particular reference to the distinction between little cigars and cigarettes. The proposals contained in this document clarify the application of existing statutory definitions and update and codify administrative policy in order to provide clearer and more objective product classification criteria. These clarifications are intended to reduce possible revenue losses through the misclassification of cigarettes as little cigars. In addition, these clarifications should facilitate the determination of payments under the Master Settlement Agreement.

DATES: We must receive your written comments on or before December 26, 2006.

ADDRESSES: You may send comments to any of the following addresses:

- Director, Regulations and Rulings Division, Alcohol and Tobacco Tax and Trade Bureau, (Attn: Notice No. 65), P.O. Box 14412, Washington, DC 20044-4412.

- 202-927-8525 (facsimile).
- nprm@ttb.gov (e-mail).
- http://www.ttb.gov/tobacco/tobacco_rulemaking.shtml (An online comment form is posted with this notice on our Web site).

- <http://www.regulations.gov> (Federal e-rulemaking portal; follow instructions for submitting comments).

You may view copies of this notice, the related rulemaking petitions, and any comments we receive on this proposed rule by appointment at the TTB Information Resource Center, 1310 G Street, NW., Washington, DC 20220. To make an appointment, call 202-927-2400. You may also access copies of this notice and any comments we receive on this proposal online at http://www.ttb.gov/tobacco/tobacco_rulemaking.shtml.

FOR FURTHER INFORMATION CONTACT:

Linda Wade Chapman, Regulations and Rulings Division, Alcohol and Tobacco Tax and Trade Bureau, 1310 G Street, NW., Suite 200-E, Washington, DC 20220; telephone 202-927-8210; or e-mail Linda.Chapman@ttb.gov.

SUPPLEMENTARY INFORMATION:**Background***Statutory Provisions*

Chapter 52 of the Internal Revenue Code of 1986 (IRC) sets forth the Federal excise tax and related provisions that apply to tobacco products manufactured in, or imported into, the United States. Section 5702(c) of the IRC (26 U.S.C. 5702(c)) defines the term “tobacco products” as “cigars, cigarettes, smokeless tobacco, pipe tobacco, and roll-your-own tobacco.” In addition, sections 5702(a) and (b) of the IRC define the terms “cigar” and “cigarette” as set forth below:

Sec. 5702. Definitions.

When used in this chapter—

(a) Cigar.

“Cigar” means any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco (other than any roll of tobacco which is a cigarette within the meaning of subsection (b)(2)).

(b) Cigarette.

“Cigarette” means—

(1) any roll of tobacco wrapped in paper or in any substance not containing tobacco, and

(2) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in paragraph (1).

The distinction between cigars and cigarettes is important for Federal tax purposes because the rate of tax varies from one product class to another. Section 5701 of the IRC (26 U.S.C. 5701) prescribes the following rates of tax for cigars and cigarettes:

Sec. 5701. Rate of tax.

(a) 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, \$1.828

cents per thousand (\$1.594 cents per thousand on cigars removed during 2000 or 2001);

(2) *Large cigars.* On cigars weighing more than 3 pounds per thousand, a tax equal to 20.719 percent (18.063 percent on cigars removed during 2000 or 2001) of the price for which sold but not more than \$48.75 per thousand (\$42.50 per thousand on cigars removed during 2000 or 2001).

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.

(b) Cigarettes.

On cigarettes, manufactured in or imported into the United States, there shall be imposed the following taxes:

(1) *Small cigarettes.* On cigarettes, weighing not more than 3 pounds per thousand, \$19.50 per thousand (\$17 per thousand on cigarettes removed during 2000 or 2001).

(2) *Large cigarettes.* On cigarettes, weighing more than 3 pounds per thousand, \$40.95 per thousand (\$35.70 per thousand on cigarettes removed during 2000 or 2001); except that, if more than 6 1/2 inches in length, they shall be taxable at the rate prescribed for cigarettes weighing not more than 3 pounds per thousand, counting each 23/4 inches, or fraction thereof, of the length of each as one cigarette.

Section 7805 of the IRC (26 U.S.C. 7805) gives the Secretary of the Treasury the general authority to issue regulations to carry out the provisions of the IRC. In addition, section 5722 of the IRC (26 U.S.C. 5722) gives the Secretary authority to require from manufacturers or importers of tobacco products reports containing such information, in such form and at such times, as the Secretary may prescribe by regulations. Finally, section 5723(a) of the IRC (26 U.S.C. 5723(a)) gives the Secretary authority to prescribe regulatory standards for the packaging of tobacco products. Further, section 5723(b) of the IRC gives the Secretary the authority to prescribe regulations requiring marks, labels, and notices on every package of tobacco products.

Regulatory Provisions

Regulations implementing the tobacco product provisions of Chapter 52 of the IRC are contained in 27 CFR parts 40 (manufacture of tobacco products and cigarette papers and tubes), 41 (importation of tobacco products and cigarette papers and tubes), 44 (exportation of tobacco products and cigarette papers and tubes, without payment of tax, or with drawback of tax), and 45 (removal of tobacco products and cigarette papers and tubes, without payment of tax, for use of the United States). These regulations are administered by the Alcohol and Tobacco Tax and Trade Bureau (TTB).

Sections 40.11, 41.11, 44.11, and 45.11 of the TTB regulations (27 CFR 40.11, 41.11, 44.11, and 45.11) include definitions of cigars and cigarettes that follow the statutory definitions without further elaboration. The tax rates imposed on cigars under the IRC are reflected in §§ 40.21 and 41.31 of the TTB regulations (27 CFR 40.21 and 41.31) and the IRC tax rates imposed on cigarettes are reflected in §§ 40.23 and 41.32 of the TTB regulations (27 CFR 40.23 and 41.32).

The TTB regulations that set forth notice requirements for packages of cigars are found at 27 CFR 40.214, 41.73, 44.186, 44.253, and 45.44. These regulations provide that before removal subject to tax (§§ 40.214 and 41.73) or before removal from a factory (§ 44.186) or before withdrawal from a customs warehouse (§ 44.253) or before removal (§ 45.44), every package of cigars must have adequately imprinted on it, or on a label securely affixed to it, the designation “cigars”, the quantity of cigars contained in the package, and for small cigars, the classification of the product for tax purposes (that is, either “small” or “little”). The TTB regulations that set forth cigarette notice requirements are found at 27 CFR 40.215, 41.74, and 45.45. These regulations provide that before removal subject to tax (§§ 40.215 and 41.74) or before removal (§ 45.45), every package of cigarettes must have adequately imprinted on it, or on a label securely affixed to it, the designation “cigarettes,” the quantity of cigarettes in the package, and the classification for tax purposes (that is, for small cigarettes, either “small” or “Class A”, and for large cigarettes, either “large” or “Class B”).

Current Standards and Methods Used To Differentiate Between Little Cigars and Cigarettes for Excise Tax Purposes

In connection with the administration of Chapter 52 of the IRC, TTB's predecessor agency, the Bureau of Alcohol, Tobacco and Firearms (ATF), published ATF Ruling 73–22 and Procedures 73–5 and 76–2 to provide the tobacco industry and the public at large with the Agency's official interpretation and guidance with regard to the classification of cigars and cigarettes for excise tax purposes. A ruling published by ATF or TTB represents an Agency interpretation of applicable statutes or regulations or other statement of Agency policy. A published procedure provides technical guidance on how to fulfill a regulatory requirement, for example by providing detailed analytical criteria that the Agency uses to assess compliance with

the regulation in question. The ruling and two procedures in question, and TTB's adherence to them, are discussed below.

ATF Ruling 73–22

ATF Ruling 73–22 was published in 1973 to update the criteria for determining whether a tobacco product wrapped in a “substance containing tobacco” is a cigar or cigarette for tax purposes. This ruling restated the basic provisions of, and superseded, Revenue Ruling 69–198, C.B. 1969, pg. 1,359 (Internal Revenue). Specifically, Ruling 73–22 amplified the three fundamental factors that govern the classification of little cigars: the wrapper, the filler, and the product packaging and labeling.

With regard to the wrapper material used to manufacture cigars, Ruling 73–22 states the following:

The legislative history concerning Public Law 89–44 indicates the terms “substance containing tobacco” as used in 26 U.S.C. 5702 and “reconstituted tobacco” were used synonymously. In the trade and in general terminology, “reconstituted tobacco” is ground or pulverized tobacco mixed with various adhesive agents and/or cellulose fibers derived from tobacco or other sources and formed into sheets.

For a wrapper material to be considered a “substitute [sic] 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.

Ruling 73–22 states that a combination of other factors must be considered in determining whether a product wrapped in a “substance containing tobacco” is a cigar or a cigarette. With regard to the filler tobacco, the ruling goes on to state:

For a product to be a cigar the filler must be substantially of tobaccos unlike those in ordinary cigarettes and must not have any added flavorings which would cause the tobaccos to have the taste or aroma generally attributed to cigarettes. The inclusion of flue-cured or aromatic (Oriental) tobaccos—which traditionally have been the primary constituents of cigarette filler—can contribute significantly to making a product cigarette-like, and if the product also is of the typical cigarette size and shape, has a typical cigarette-type filter, and is in a cigarette-type package, the inclusion of these tobaccos could cause the product to be classified as a cigarette rather than a cigar. Conversely, if a product is made predominantly of cigar-type tobaccos with distinctive cigar taste and aroma, if it does not resemble a cigarette (such as most large cigars do not), and if it is not to be marketed in a cigarette-type package, it would probably be classified as a cigar.

Ruling 73–22 states the following with reference to the issue of whether the product is likely to be offered to, or purchased by, consumers as a cigarette:

Two other factors which are relevant under the Code in determining the tax category of a product are whether the product is likely to be offered to, or purchased by, consumers as a cigarette. It is, therefore, important that the package for a product to be offered as a cigar conspicuously declare it to be a cigar and that all marketing materials and advertising clearly present the product to the consumer as a cigar and not as a cigarette. There must be no representations or implications on the package or in other merchandising or advertising materials which tend to negate the tax declaration that the product is a cigar. If the package for a cigar product is comparable to the traditional 20-cigarette soft (cup) pack or the similar hard pack, the declaration “cigars”, “small cigars”, or “little cigars” must appear in direct conjunction with, parallel to, and in substantially the same conspicuousness of type and background as the brand name each time the brand name appears. A conspicuous “cigar” declaration must appear on the front, back, and bottom panels of such a typical cigarette-type package even if the brand name does not appear on any of these panels. Cartons must similarly declare the product to be a cigar in conjunction with the brand name and a conspicuous cigar declaration must appear on each panel of the carton which is likely to be visible in a retail sale display.

TTB continues to apply the principles reflected in Ruling 73–22 in preparing responses to requests from manufacturers, importers and other parties for advance rulings or other advice on the tax classification of cigars and cigarettes.

Ruling 73–22 is available on the TTB Web site at <http://www.ttb.gov>.

ATF Procedure 73–5

In 1973, ATF published Procedure 73–5, the purpose of which was to set forth some basic analytical methods for use by ATF in determining if specific reconstituted tobacco material is acceptable as a cigar wrapper, and to determine if a product wrapped in such material is a cigar or cigarette for tax purposes. Specifically, Procedure 73–5 established analytical examinations and tests to provide objective information for use with other relevant factors in: (1) Distinguishing between those materials that contained sufficient tobacco to be classified as reconstituted tobacco and those that did not, (2) differentiating between the filler tobaccos typically used in cigars and those generally used in cigarettes, and (3) determining if a smoking product wrapped in reconstituted tobacco is taxable as a cigar or as a cigarette under the IRC.

The examinations and tests provided in Procedure 73–5 are as follows:

WRAPPER EXAMINATIONS AND TESTS

Color	Visual examination with general description and statement as to whether it is in the range of natural leaf tobaccos traditionally used as a wrapper for American cigars.
Composition	Microscopic examination for tobacco particles, vegetable fibers, mineral particles, adhesives, other substances.
Cellulose Fibers	Microscopic examination may be reported as none, few, numerous; or chemical tests may be used.
Texture	Microscopic examination described as rough, smooth, etc.
Tensile Strength	Instrumentation can be used, but usually only a physical manipulation of stretching, tearing, etc. Generally reported as degree of dry and wet tensile strength.
Paper-like Qualities	Subjective evaluation based on appearance, tensile strength, number of fibers, general visual character, and evaluation of chemical composition as shown later.
Taste	Degree of tobacco-like character.
Burning	Described as more characteristic of tobacco or of paper.
Fragments of Tobacco	Microscopic examination, described as large, small, pulverized, none, etc.
Percent moisture.	
Percent total ash.	
Percent acid insoluble ash.	
Percent sodium.	
Percent potassium.	
Percent calcium.	
Other elements may be determined.	
pH of water extract.	
Percent nicotine.	
Sequential Differential Solvent Extractions as described in Section 7.08.	

FILLER EXAMINATIONS AND TESTS

Composition	Microscopically observed character of filler, expressed as relative proportions of basic tobacco types.
Taste	Tobacco character, described as heavily fermented type, fire-cured type, etc., and other descriptives such as added menthol, etc.
Odor before smoking	Expressed as to kind of tobacco product character, such as mild cigar-like, etc.
Odor when smoking	Expressed as to kind of tobacco product character such as mentholated cigarette-like, etc.
Percent moisture.	
Percent total ash.	
Percent acid insoluble ash.	
Percent sodium.	
Percent potassium.	
Percent calcium.	
Other elements may be determined.	
pH of water extract.	
Percent nicotine.	
Sequential Differential Solvent Extractions as described in Section 7.08.	

PRODUCT EXAMINATIONS AND TESTS

Diameter	In millimeters to the nearest tenth.
Length (Including filter)	In millimeters to the nearest tenth.
Weight of 1,000 (Including filters)	In pounds to nearest hundredth.
Added distinctive flavorings not otherwise reported, such as any included in the filter.	
pH of smoke.	
Opinions of cigarette smokers.	

Procedure 73–5 is available in its entirety on the TTB Web site at <http://www.ttb.gov>.

ATF Procedure 76–2

ATF Procedure 76–2 was published in 1976 to supersede, in part, ATF Procedure 73–5.

Specifically, this procedure sets forth an updated sequential solvent extraction method to replace the one contained in Procedure 73–5. The updated method was essentially the same as the method it replaced except that the instructions

were amplified and the standards were redetermined on a residue-free solvent basis. The decision to update the method was based in part on information received from some industry members to the effect that the method contained in Procedure 73–5 was not sufficiently specific for it to be effectively employed in their laboratories. In addition, it was noted that the extractive procedure used in the method did not account for the possibility of varying residues from the solvents themselves, thus leading to

erroneous test results. The solvents used in the sequential solvent extraction method under Procedure 76–2 are as follows:

- Petroleum Ether;
- Tetrahydrofuran;
- Acetonitrile;
- 95% Ethanol; and
- Dioxane—20% Water.

Procedure 76–2 is available in its entirety on the TTB Web site at <http://www.ttb.gov>.

Current Analytical Procedures

TTB has in recent years supplemented most of the methodologies contained in ATF Procedures 73–5 and 76–2 with other more efficient methodologies. In particular, TTB no longer uses the sequential solvent extraction method to test tobacco products. With regard to analyzing the filler tobaccos used in cigars and cigarettes, TTB has adopted a less labor intensive analytical method that does not require use of the toxic solvents used in the sequential solvent extraction method. Although this method, titled “Characterization of Tobacco Products by High-Performance Anion Exchange Chromatography-Pulsed Amperometric Detection,” was published in the *Journal of Agricultural and Food Chemistry* in 1996, it has not been published as an Agency procedure. The published abstract for this method is as follows:

A simple and reproducible method has been developed for the classification of cigarette versus cigar tobacco. Although the tobacco used for both cigars and cigarettes may be of the same natural origin, tobacco types and processing parameters alter the relative amounts of natural constituents (e.g., carbohydrates). In this method, carbohydrates are obtained by water extraction. The extracts are then analyzed using high-performance anion exchange chromatography followed by pulsed amperometric detection. The relative amounts of glucose, fructose, and sucrose between cigarette and cigar tobaccos are used for their characterization. Complete analysis of a tobacco product is achieved in less than 60 min.¹

In addition to the method mentioned above, ATF developed a method to determine the quantity of nicotine in tobacco products, specifically in cigar and cigarette wrapper materials. This method was not published as an Agency procedure, but was published in the *Journal of AOAC International* under the title “Quantitation of Nicotine in Tobacco Products by Capillary Electrophoresis,” in 2002. The published abstract for this method is as follows:

A simple and rapid capillary electrophoresis (CE) method was developed for the quantitation of nicotine in commercial tobacco products. The method involves a 6 min run at 30 kV, using a 50mM phosphate buffer (pH 2.5), paraquat as internal standard, and UV detection at 260 nm. Nicotine was extracted from tobacco products in <15 min. Recoveries from spiked extracts were >95%, and the extraction efficiencies of water, 1M HCl, 1M acetic acid, 5mM phosphate buffer

(pH 2.5), and 1% triethanol amine were similar. Nicotine concentrations in 67 samples of cigarettes, cigars, and bidis varied between 0.37 and 2.96% (w/w). An established gas chromatography/mass spectrometry method using toluene extraction consistently yielded lower nicotine values than the CE method. Experimental evidence suggests that this is due to insufficient extraction of nicotine by toluene.²

Total Reducing Sugars Study

Over the last several years, TTB has seen an increase in the number of tobacco products labeled “Little Cigars” submitted to the Agency by members of the U.S. tobacco industry, importers, and other Federal agencies requesting letter rulings or other advice regarding the proper classification of the products under the IRC. In light of this increased interest in the tax classification of little cigars, and because of a desire to improve the efficacy of the analytical standards discussed above, TTB decided to explore other analytical avenues that might provide a more reliable standard for distinguishing between cigars and cigarettes.

We found that U.S. manufacturers conduct analyses of their tobacco products with a flow analyzer, which has been specifically designed, developed, and validated for analysis of target tobacco components, including total reducing sugars and nicotine (“total reducing sugars” encompasses all monosaccharides and disaccharides). Since this instrument has become a widely used and accepted analytical tool within the tobacco industry, we concluded that it would be appropriate for our inquiry.

Accordingly, in 2005, TTB obtained an Astoria 2 + 2 Flow Analyzer from Astoria-Pacific International in order to conduct a study of cigar and cigarette samples obtained for testing. Our study was grounded on the fact that cigars and cigarettes contain different blends of tobacco/cigarettes are made primarily from flue-cured or light air-cured (burley) and oriental (Turkish) tobaccos, whereas cigars are usually made from air-cured and fermented tobaccos. Many of the significant chemical differences between cigar and cigarette tobaccos are related to the curing and/or fermentation processes used to manufacture them.

One of the most significant chemical differences between cigars and cigarettes is the level of total reducing sugars, which varies significantly depending on the processing of the filler

material. Flue-cured tobaccos, which are high in reducing sugars, are predominant in cigarettes sold in the U.S. market.³ Furthermore, sugar is often added directly to cigarette filler tobaccos to “balance” smoke flavor.⁴ In contrast, cigars are manufactured from processed tobaccos that contain relatively low levels of sugars. Therefore, TTB surmised that comparing the sugar content in the filler tobacco used in cigars to the sugar content in the filler tobacco used in cigarettes might yield a clear and objective line of distinction between these two classes of tobacco products.

In the study, TTB analyzed 93 products labeled either as “cigars” (large cigars and little or small cigars) or as “cigarettes.” The products were analyzed to determine the quantity of total reducing sugars in each product using an Astoria 2 + 2 Flow Analyzer. In the study, sucrose was converted to a monosaccharide in order to result in a total reducing sugars value for each product.

Products were chosen for the study based largely on recent sales history in the domestic market. For cigarettes, products were obtained of the five largest manufacturers whose combined market share totals approximately 90 percent of the domestic market. Approximately 140 cigarette products were collected for analysis, and to date, 47 have been analyzed for total reducing sugars. For cigars, products were also obtained of the manufacturers with the most significant domestic presence. In all, 190 cigars and little cigar products were obtained, of which 46, to date, have been analyzed for total reducing sugars.

The 93 analyzed samples were selected to provide a robust representative sample of the domestic marketplace for both cigars and cigarettes. Specifically, samples of “cigarettes” were chosen to ensure that the most common brand descriptors were represented (full flavor, mild, light, ultra light, menthol) as well as some of the less common descriptors, such as natural cigarettes. The tested “cigars” were chosen to reflect the diversity of the product lines (flavored, machine rolled, premiums, and little cigars). In addition, the little cigars used in the study were those that closely resembled cigarettes in length, diameter, and uniformity of the cylinder and in having a filter. While it is anticipated

¹ Zook, C., Patel, P., LaCourse, W., & Ralapati, S., *J. Agric. Food Chem.*, Vol. 44, No. 7, 1996, Characterization of Tobacco Products by High-Performance Anion Exchange Chromatography-Pulsed Amperometric Detection.

² Clarke, M., *J. AOAC International*, Vol. 85, No. 1, 2002, Quantitation of Nicotine in Tobacco Products by Capillary Electrophoresis.

³ Abdallah, F. “Blending Concepts. ABC Blend Development and Maintenance”, *Tobacco Reporter*, April 2003, pp. 72–78.

⁴ Leffingwell, J. “Chemical Constituents of Tobacco Leaf and Differences among Tobacco Types”, February 2001.

that future additions to the data set will provide greater insight into the chemical differences among these products, it is not expected that more data will significantly alter the overall results of the study.

Each tobacco product was prepared for analysis by separating the wrapper material from the filler and drying the filler at 90° C for one hour in a convection oven. The filler was then ground into a coarse powder using a Wiley Mill equipped with a 20 mesh screen and transferred to airtight containers. Approximately 100 mg of the ground fill material was accurately weighed into a flask and mixed with 100 milliliters of a 1% acetic acid solution. Extraction of sugars from the ground fill material was facilitated by

agitation using a wrist action shaker for ½ hour. The mixture was then filtered (to remove the remaining solid material) using Whatman 114V pleated filter paper and poured into sample vials. Three sample vials were prepared for each tobacco sample.

The total reducing sugars results obtained for each tobacco sample were the average of nine injections into the flow analyzer (three injections for each of the three sample vials prepared for each tobacco sample). The results obtained by using this method were reported as percent by weight. Further, the method accurately reports the percentage weight of reducing sugars in each sample at levels from 2% to 40% by weight. As expected, the cigar samples showed levels below 2%.

Because the values for reducing sugars found in cigars are below 2%, the TTB laboratory could not report those values with the exactitude reportable for values within the 2% to 40% range.

Consequently, any value below 2% for total reducing sugars will be reported as "<2%." However, even though 2% is the smallest percentage of total reducing sugars that can be quantitatively determined with suitable precision and accuracy using this method, the values obtained for cigars are still valid for the purpose of distinguishing cigars from cigarettes using total reducing sugars. Statistical analyses of the results of the study are summarized in the table below.

Sample	Range (% by weight)	Mean (% by weight)	Interval @ 99%
Cigars	Below 2	Below 2	*n/a
Little cigars	Below 2	Below 2	*n/a
Cigarettes	7.47 to 17.94	11.85	±0.85

*n/a = not applicable.

The results obtained for total reducing sugars for the cigars tested differed greatly from the results obtained for cigarettes tested. The data obtained from the study is listed in the chart below according to tax class and sample number.

TOTAL REDUCING SUGARS (TRS) STUDY RESULTS	
Sample number	TRS (percent by weight)
Large Cigars	
1	0.4
2	0.5
3	0.6
4	0.8
5	0.8
6	0.6
7	0.7
8	0.6
9	0.6
10	0.3
11	0.5
12	0.7
13	0.9
14	0.7
15	0.5
16	0.7
17	0.6
18	0.5
19	0.6
20	0.5
21	0.4
22	0.4
23	0.8
24	0.7
25	0.6
26	0.3
27	0.3
28	0.5

TOTAL REDUCING SUGARS (TRS) STUDY RESULTS—Continued

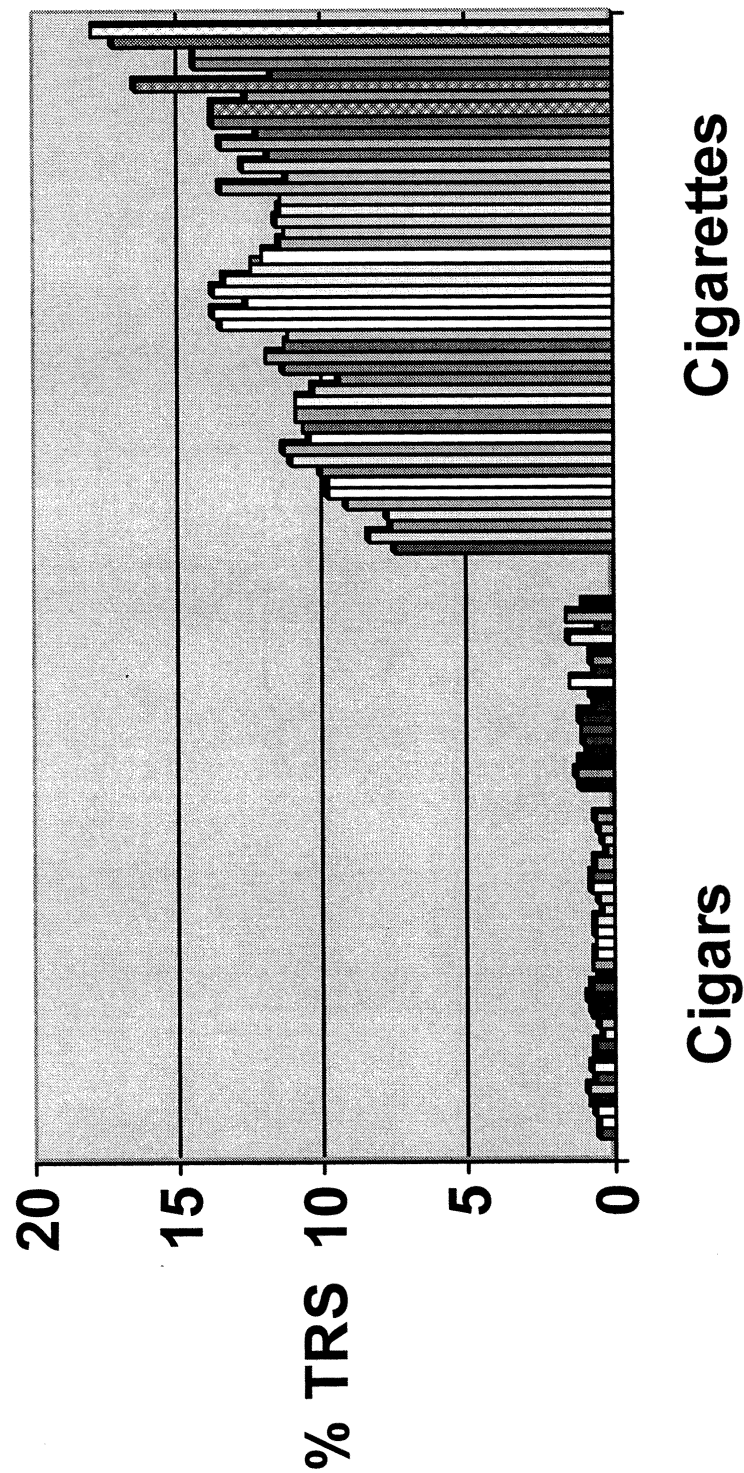
Sample number	TRS (percent by weight)	
29	0.5	
Little Cigars		
31	1.2	
32	1.3	
33	1.1	
34	0.8	
35	1.0	
36	1.0	
37	1.2	
38	0.5	
39	0.7	
40	1.4	
41	0.6	
42	0.8	
43	0.8	
44	1.5	
45	0.5	
46	1.6	
47	1.0	
Sample number	TRS (percent by weight)	Uncertainty (+/-)
Cigarettes		
51	7.47	0.12
52	8.38	0.41
53	7.61	0.15
54	7.71	0.14
55	9.19	0.15
56	9.82	0.09
57	9.80	0.15
58	10.06	0.09
59	11.09	0.08
60	11.31	0.41
61	10.42	0.16

Sample number	TRS (percent by weight)	Uncertainty (+/-)
62	10.64	0.23
63	10.89	0.45
64	10.90	0.15
65	10.31	0.16
66	9.43	0.14
67	11.38	0.12
68	11.93	0.18
69	11.28	0.18
70	11.14	0.17
71	13.51	0.26
72	13.75	0.16
73	12.63	0.22
74	13.74	0.19
75	13.41	0.21
76	12.43	0.17
77	12.06	0.09
78	11.49	0.21
79	11.28	0.07
80	11.57	0.16
81	11.50	0.16
82	11.40	0.22
83	13.52	0.12
84	11.21	0.28
85	12.73	0.10
86	11.86	0.21
87	13.57	0.15
88	12.27	0.22
89	13.74	0.25
90	13.76	0.10
91	12.61	0.23
92	16.44	0.24
93	11.74	0.30
94	14.46	0.73
95	14.44	0.32
96	17.21	0.26
97	17.94	0.36

The following is a graphical representation of the study results listed above.

BILLING CODE 4810-31-P

Total Reducing Sugars (TRS)



Petitions for Rulemaking

After TTB began developing a plan to clarify and amplify its regulations pertaining to the classification of cigars and cigarettes, the Agency received three petitions for rulemaking concerning this issue. One petition, including a later follow-up to that petition, was submitted by the Cigar Association of America, Inc. (CAA). Another petition came from the Lorillard Tobacco Company (Lorillard) and the R.J. Reynolds Tobacco Company (RJR). The third petition, which included a later amendment to that petition, was submitted by 39 States and one U.S. territory.

CAA Petition

On December 19, 2005, the CAA submitted a petition to TTB specifically requesting rulemaking on little cigars in order to “maintain the integrity of the little cigar class.” In this petition, the CAA urged TTB to expedite its proposed rule to distinguish between cigars and cigarettes due to what the CAA believes is widespread confusion within the tobacco industry concerning how to classify little cigars and cigarettes for Federal regulatory and tax purposes.

In their petition, the CAA stated that since the signing of the Master Settlement Agreement (MSA) by the several States and the cigarette companies in 1998, it has witnessed a proliferation of new brands of domestic and imported little cigars entering the U.S. market. Further, the CAA stated that there is confusion in many of the States, whose attorneys general believe that little cigars are cigarettes in disguise, specifically designed to circumvent the provisions of the MSA. Hence, the CAA stated that the distinction between little cigars and cigarettes is an issue requiring Federal action and that TTB should assume the leadership role in this area.

Lorillard-RJR Petition

The Lorillard-RJR petition, dated January 9, 2006, requested that TTB amend its regulations regarding the classification of little (small) cigars. The petitioners stated that they propose these changes because current regulatory and interpretive ruling standards “do not adequately focus the resources of TTB on the many new products that have entered the marketplace.” The petitioners went on to state:

Lorillard and R.J. Reynolds believe that changes in the regulations governing little cigars are necessitated by the increased differential between tobacco product

categories with respect to taxes, fees and assessments paid. The relative burden faced by cigarettes has increased by a far greater amount than cigars in recent years, creating an economic advantage for the little cigar classification. In addition, companies participating in the “Master Settlement Agreement” (“MSA”) must make payments to the States based on sales of cigarettes, not cigars. As a result of these and other factors, since the signing of the MSA a number of tobacco products have been introduced into the domestic market and are being improperly packaged, labeled, and classified as little cigars in order to bypass federal and state tax burdens, reporting requirements, and MSA payments.

In a few short years, the tobacco market has changed substantially. A large number of products have been introduced and marketed as “little cigars,” yet they are packaged like cigarettes, and in many cases have the look, taste, flavorings, and characteristics of cigarettes. Yet they are much less expensive, avoiding the taxes and MSA burdens imposed upon cigarettes.

The petitioners highlighted several reasons why they believe that it is important for TTB to update its regulations governing the classification of little cigars and cigarettes. They noted the following regarding the changes in domestic invoice volume for little cigars and cigarettes:

In 1998, the domestic invoice volume for little cigars was 1,638,000,000 units. By 2004, this volume had risen to 2,702,000,000 units, an increase of 64.96%. By contrast, domestic cigarette volume was 22,755,000,000 packs in 1998. By 2004, domestic volume had fallen to 18,922,000,000 packs, a decrease of 16.84%.

The petitioners further stated:

In recent years, lines have been blurred in the marketing of cigarettes and little cigars. For example, little cigars are increasingly sold in packs of 20, much like cigarettes, with packs that are similar in size to a pack of cigarettes.

In addition to the decrease in domestic sales of cigarettes, the petitioners stated that the monetary obligations provided in the MSA have increased the financial burden on cigarette makers whereas little cigar makers are unaffected since cigars, little and large, are not covered under the MSA. The petitioners noted in this regard that the financial impact of compliance with the MSA has been estimated to be 50 cents per pack.

Further, the petitioners state that State excise taxes on cigarettes have increased significantly over the last several years. These tax increases, when combined with MSA payments, have driven up the cost of cigarettes, thus further widening the cost differential between little cigars and cigarettes. To rectify the problems identified in the petition and highlighted above, the petitioners

request that TTB initiate a number of specific actions.

The first action requested is that TTB publish a notice of proposed rulemaking to update the existing regulations that pertain to the classification of little cigars and cigarettes. The petitioners request several specific regulatory changes described in more detail below.

The petitioners urged TTB to take steps beyond ATF Ruling 73–22 to strengthen the reporting requirements placed on manufacturers and importers of little cigars. The petitioners stated:

ATF Ruling 73–22 specifically allows the TTB to “reappraise and update the criteria” for defining cigars or cigarettes due to “[c]hanging technology and merchandising methods.” Therefore, the ruling provides the TTB with the explicit authority to amend the regulations governing cigars in light of changes in the marketplace. While we believe that the factors in ATF Ruling 73–22 continue to provide a logical basis for the classification of little cigars and cigarettes, we also believe that the non-binding and voluntary nature of the reporting requirements under this Ruling are no longer effective in the current marketplace.

We think a more targeted approach by TTB will better serve to promote effective enforcement and reduce current market confusion of little cigars. This approach, outlined below, should include an additional disclosure requirement for new brands that may be contributing to potential consumer confusion.

In addition, the petitioners requested that TTB distinguish between little cigar brands marketed prior to the signing of the MSA and those that appeared on the market only after the MSA, by creating a presumption “in favor of those little cigar brands marketed prior to the existence of the financial disincentives created by the MSA.” While those brands would still be subject to monitoring and challenge as under existing regulations, there would be a rebuttable presumption that such brands continue to comply with all TTB requirements, and are likely to be offered to, and purchased by, consumers as little cigars.

Further, the petitioners urged TTB to establish a certification procedure for post-MSA little cigar brands. The petitioners proposed the following in this regard:

For those little cigar brands initially marketed after the signing of the MSA (November 23, 1998), a certification requirement should be created. Such certification would require each manufacturer (under 27 CFR Part 40) or importer (under 27 CFR Part 41) to certify to the TTB that each of the factors set forth in ATF Ruling 73–22 have been satisfied with respect to such brand. For enforcement purposes, each of the seven conditions currently required for an advanced ruling

should be included in the certification submission to TTB.

We recommend that this certification be made a one time requirement for post-MSA brands. In addition, any material change in the appearance, type of tobacco used in the filler, and packaging and labeling of the product would trigger a recertification process. New brands marketed after the completion of the rulemaking would also be required to comply with the certification process.

However, we do not recommend that the certification process include any affirmative action by the TTB in order for the brand to be eligible for entering into commerce. In other words, there would not be a pre-approval process prior to the marketing of a post-MSA brand. Rather, the certification submissions would form the basis for an initial level of TTB analysis and review, focusing on those products in the marketplace where the most significant classification issues are likely to exist.

The petitioners also requested that TTB amend the regulations to provide for a third party challenge procedure. This procedure would be open to any party to demonstrate that tobacco products introduced into commerce as "small" or "little" cigars do not meet the regulatory criteria established by TTB.

Finally, the petitioners requested that any efforts to modernize the TTB regulations be done in conjunction with the U.S. Customs and Border Protection as they relate to tobacco product imports. In addition, the petitioners recommended the inclusion of post-MSA presumption and certification requirements in 27 CFR part 41.

CAA Petition Follow-Up

On February 21, 2006, the CAA submitted a letter with reference to its December 19, 2005, petition. This letter is directed to certain issues raised in the Lorillard-RJR petition.

The CAA states in this letter that the Lorillard-RJR proposal does not offer much in the way of establishing standards for distinguishing between little cigars and cigarettes, but instead focuses on compliance and enforcement issues pertaining to these two products. The CAA further states that the Lorillard-RJR proposal would impose regulatory requirements on one small segment of the tobacco industry that would exceed those imposed on the rest of the industry. The CAA notes in this regard that the domestic sales volume figures for little cigars and cigarettes provided in the Lorillard-RJR petition are misleading because the petition uses "units," or individual sticks, for little cigars and "packs" for cigarettes, which suggests that the cigarette industry is ten times the size of the little cigar industry

when, in fact, it is over 200 times the size.

The CAA goes on to state:

The cigarette company proposal also fundamentally mischaracterizes the little cigar industry by suggesting incorrectly that little cigars are a recent phenomenon. Little cigars have been on the market for almost 40 years and, because they were first made on old cigarette machines, have always had a superficial resemblance to cigarettes. Little cigars, however, have always differed from cigarettes, in both composition and marketing. They are made of cigar—not cigarette—tobacco, they are wrapped in leaf tobacco or in reconstituted tobacco (the material approved by BATF/TTB for use on cigar making equipment), and they are clearly labeled and promoted as little cigars. While it is true that there are new entrants in the little cigar market since the finalization of the MSA, it is unreasonable to suggest that all little cigars, or even all those introduced since 1998, are suspect.

For two reasons, the CAA opposes the Lorillard-RJR proposal for a compliance and enforcement approach. First, the proposal does not provide any new guidance on how to distinguish between little cigars and cigarettes but rather suggests that the factors in ATF Ruling 73–22 continue to provide a logical basis for the classification of these products. The CAA argues that Ruling 73–22 needs to be supplemented and that, until this is done, it is premature to consider compliance and enforcement procedures.

The CAA then states:

Second, even with new guidance in place, the cigarette company proposal for compliance and enforcement is unacceptable. It would create a "presumption" in favor of little cigars marketed prior to the Master Settlement Agreement of November 23, 1998. This "presumption," however, is meaningless, since pre-MSA brands would "still be subject to monitoring and challenge as under existing regulations." More importantly, the unstated corollary to the favorable presumption for pre-MSA little cigars is that there will be a presumption against little cigars first marketed after the MSA. The implication is that any such product will be presumed to be a cigarette unless the manufacturer can demonstrate otherwise. The tax, customs, MSA and other implications of this presumption are unstated but the results would certainly include chaos and confusion, as products move between categories. This negative presumption would apparently apply to pre-MSA brands as to which there is any material change in appearance, type of tobacco used in the filler, or packaging and labeling of the product. A change in any one of these characteristics would reverse the favorable presumption, temporarily re-classifying a little cigar as a cigarette.

The CAA also opposes the Lorillard-RJR proposal that TTB create a certification procedure for post-MSA

little cigar brands, arguing that it is premature to discuss "certification" of a product as a little cigar without knowing what test is to be used. Under the Lorillard-RJR proposal, all of the seven conditions specified in ATF Ruling 73–22 for an advance ruling would have to be included in the certification, which would also apply to pre-MSA brands if there is any material change in the product or packaging. The CAA asserts that such an approach is tantamount to a pre-approval scheme, as it would result in immediate review and inspection of a product coming to market, without any basis for such action.

Finally, the CAA takes issue with the Lorillard-RJR proposal for a "third party challenge procedure," arguing that such a procedure would be an invitation to those with a variety of interests to force little cigar manufacturers to continually defend their products from unwarranted and unjustified attack. In addition, the CAA noted that because under Federal statute the tax status of any particular product must be held in confidence by TTB, Federal legislation would be required for TTB to create and implement such a third party challenge procedure.

The 23 States Joint Petition and Amendment

On April 24, 2006, the States of Montana, Wisconsin, Oklahoma, Utah, Oregon, South Dakota, Vermont, California, Louisiana, Delaware, New York, Arizona, Arkansas, Nebraska, West Virginia, New Mexico, Rhode Island, Wyoming, Nevada, Kentucky, Idaho, Hawaii, and Pennsylvania (the petitioner States) submitted a petition to TTB requesting the repeal of the definitions of "cigar" and "cigarette" as provided in 27 CFR 40.11, 41.11, 44.11, and 45.11. The petitioner States also propose new rules defining "cigar" and "cigarette" as used in 26 U.S.C. 5702 and new procedural rules for cigar and cigarette rulings. The petitioner States say that they take an active role in protecting the health and safety of their citizens. They also state that they find that the tax classification of cigars and cigarettes allows products that are actually cigarettes to be taxed and sold as cigars. Further, the petitioner States maintain that this is a growing trend and that it endangers the integrity of the Federal and State tax systems in addition to the MSA. They also state that the trend places the health and safety of U.S. citizens, especially youths, at risk. Specifically, the petitioner States address the following topics in their petition:

- Public Health;

- Federal Definition of Cigar and Cigarette;
- Lost Tax Revenues;
- Evasion of MSA Payments;
- Evasion of State Escrow and Cigarette Directory Laws;
- Health Warnings and Ingredient Reporting;
- Confusion in the Marketplace; and
- Proposed New Rules.

Public Health

The petitioner States address several concerns regarding the effect that little cigars have on public health. They state that young people are beginning to smoke little cigars at a higher rate than they smoke cigarettes. Thus, the petitioner States are afraid that this increase will reverse the gains they have made in lowering the rate of cigarette smoking in this segment of the population. They also allege that young people have greater access to little cigars than cigarettes, because in many states cigarettes are required to be sold in packages of 20 sticks or more, whereas there is no such requirement for little cigars. The petitioner States assert that little cigars that are sold in packages of less than 20 sticks, such as packages of eight sticks, five sticks, or one stick, would be less expensive and thus more accessible for younger buyers than a package of 20 sticks. They also note that the flavors such as strawberry, cherry, and vanilla used in some little cigars make these products attractive to the young.

The petitioner States also address the general health effects of cigars. Specifically, they state that “[C]igar smokers face a risk of death from laryngeal, oral or esophageal cancer that is 4 to 10 times greater than the risk faced by nonsmokers.”

The petitioner States argue that sales of little cigars are on the increase and that in some instances the marketing of these products can be misleading. Specifically, they state that “[L]ittle Cigar makers have encouraged smokers to identify Little Cigars as cigarettes through their marketing practices.”

Federal Definition of Cigar and Cigarette

The petitioner States included the following points concerning the evolution of the Federal definitions of cigar and cigarette:

Traditionally cigars have been wrapped in a leaf of tobacco. Cigars are made of air-cured tobacco that is aged and subjected to a multi-step fermentation process that reduces sugar content. Traditionally, cigars are also unflavored. Cigar smoke is not intended to be inhaled, so traditionally cigars do not have integrated filters. Sometimes, however, cigars have a mouthpiece made of plastic or wood

that is intended to keep stray pieces of tobacco out of the mouth. In the United States, cigars come in many styles and sizes. Small cigars generally have straight bodies and weigh between 1.3 and 2.5 grams each. Large cigars vary greatly in size and shape. They can contain from 5 to 17 grams of tobacco.

Traditionally cigarettes have been wrapped in paper. Cigarettes are made of flue-cured tobaccos, not fermented tobaccos. Cigarette smoke is intended to be inhaled into the lungs, consequently some cigarettes have cellulose acetate filters or other integrated filters that are intended to filter some of the tar out of the smoke. Cigarette manufacturers often add sugar to enhance the flavor of the cigarette smoke. They generally range from 68–121 mm. in length and are generally of less than 28 ring gauge.

Prior to 1965, “Cigar” as used in 26 U.S.C. 5702 was defined as “any roll of tobacco wrapped in tobacco” and “Cigarette” was defined as “any roll of tobacco, wrapped in paper or any substance other than tobacco.” 26 U.S.C.S. 5702.

With the advent of reconstituted tobacco, it became possible to machine wrap cigars in a mixture of paper and tobacco. Reconstituted tobacco is ground tobacco mixed with various adhesives and cellulose fibers. This blurred the line between a cigar and a cigarette. In 1965, Congress enacted Public Law 89–44 which amended the definitions of cigar and cigarette to those we have today. The legislative history of Public Law 89–44 describes how technology created the problem of distinguishing between cigars and cigarettes.

The petitioner States also included the following statement from the legislative history of Public Law 89–44 to describe the nature of the problem of distinguishing between cigars and cigarettes that led to the legislation:

The introduction of reconstituted (homogenized) tobacco for use as a wrapper for rolls of tobacco had created problems regarding the existing distinction between a cigar and a cigarette. Reconstituted tobacco can be used to wrap rolls of tobacco that closely resemble cigarettes. Moreover, it possesses many of the properties of paper, including suitability for use in high-speed cigarette manufacturing machinery.

The petitioner States further argued as follows based on the legislative history and the wording of the amended definitions: “Clearly Congress intended that ‘cigarette’ would include a product wrapped in something that contains tobacco if it was likely to be sold as or purchased as a cigarette.”

The petition noted the issuance of Revenue Ruling 69–198, which was subsequently superseded by ATF Ruling 73–22. The petition then stated the following regarding the difficulties with Ruling 73–22:

There are several difficulties with Rev. Rul. 73–22. The Ruling assumes that products that are likely to be sold as or purchased as

cigarettes will not be if they are labeled as cigars. This has led to rolls of tobacco that are filtered, appear to be cigarettes in brown wrapper and packaged in a traditional cigarette pack, are being taxed and sold to consumers as cigars because they are labeled as little cigars. But recent surveys on youth use of little cigars and the manufacturers’ own statements show that “Little Cigars” are being purchased in lieu of cigarettes. “Little Cigars” are advertised to consumers as cigarette alternatives and consumers are self-identifying “Little Cigars” as cigarettes. Consumers recognize that a product that looks like a cigarette, is filtered to be inhaled like a cigarette, and is packaged like a cigarette is, in fact, a cigarette. Unscrupulous manufacturers have exploited the loopholes in Ruling 73–22 by self-classifying cigarettes as cigars. This intentional, unscrupulous misclassification of cigarettes as cigars has resulted not only in damage to the public health but also in significant lost revenues and confusion in the marketplace.

Lost Tax Revenues

The petitioner States allege in their petition that the Federal government and the States are losing significant tax revenues because cigarettes are improperly taxed as cigars. On the Federal front, with the excise tax rate for small cigars at 4 cents per pack or 40 cents per carton and that the rate for cigarettes at 39 cents per pack or \$ 3.90 per carton, there is tax difference of \$3.50 per carton. Further, the petitioner States suggest the following with regard to lost Federal tax revenue:

From 1999 to 2005, the total little cigars sales (domestic, PR & imported) increased by over 1.7 billion sticks, or 79%. During this same time period cigarette sales decreased by over 20%. The States believe that consumers are buying the cigarettes that are intentionally misclassified as much cheaper “Little Cigars” in order to avoid the high cigarette prices. If we assume that this increase is all due to the improperly labeled products, the federal excise taxes lost total \$34 million, based upon the applicable tax rate of \$3.90 per carton.

Almost as much federal excise taxes are lost even if the shorter time period, from 2002 to 2005, is selected. From 2002 to 2005, “Little Cigar” sales increased over 1.6 billion sticks, or 69%. The federal excise taxes lost on this increase, at \$3.90 per carton, total \$32 million.

Evasion of MSA Payments

The petitioner States point out that the MSA payments to the States are based on the sales of cigarettes and not cigars. Further, they state that because MSA payments are calculated based on the Federal excise taxes paid for cigarettes, little cigars are not included in the calculation of MSA payments. The petitioner States argue that this creates a financial incentive to shift a product classification from a cigarette to a cigar to avoid making MSA payments.

They note that the MSA payment for 2005 was \$4.25 per carton.

Evasion of State Escrow and Cigarette Directory Laws

The petitioner States point out that the tobacco product manufacturers that did not join the MSA (referred to as non-participating manufacturers) still must make annual payments into escrow accounts held by the MSA signatory States; in 2005 the escrow amount per carton was \$4.16. The payments are based on the manufacturer's sales of products stamped as cigarettes in each State, and the State Directory laws list the names of the manufacturers who make escrow payments and thus are allowed to sell their products in the State. However, cigars are not subject to the escrow requirements. Therefore, the petitioner States allege that when a cigarette manufacturer is sanctioned for failing to make escrow payments, the manufacturer simply repackages its cigarettes as "Little Cigars" and continues to sell them in the State.

Health Warnings and Ingredient Reporting

The petitioner States state that the Federal Cigarette Labeling and Advertising Act (FCLAA) administered by the Federal Trade Commission (FTC) requires health warning labels and ingredient reporting for cigarettes but that no such requirement exists for cigars. The petitioner States further note that in 2000 the FTC and the seven largest cigar manufacturers entered into an agreement to place warning labels on their cigars. They argue that one of the warning labels included in the 2000 settlement, "Cigar smoking can cause cancers of the mouth and throat, even if you do not inhale", would be highly misleading if the product in question were actually a cigarette and not a cigar because the warning in question assumes that the consumer will not inhale when smoking the product.

Confusion in the Marketplace

The petitioner States point out that several States have looked at "Little Cigars" and have determined that they are cigarettes as defined by the State for state tax purposes. The petitioner States further contend that "[i]f the States change their tax definitions without a corresponding change in the TTB regulations, the inconsistencies between the two definitions cause tremendous confusion in the marketplace." To clear up this confusion, the petitioner States propose that TTB revise its definitions of cigar and cigarette so that the products can be treated consistently

under both State law and Federal law. Further, they suggest that TTB "take the lead to establish clear, objective, non-lab dependent standards that create a clear federal regulatory framework into which the states may integrate their laws."

The States' Proposed New Rules

The petitioner States included three proposed new rules designed to: (1) Preserve the integrity of the cigar classification, (2) fairly define cigarettes based upon their design characteristics, and (3) set forth a procedure for determining if a product is a cigar or a cigarette under Federal law. The States' proposed new rules were outlined in the petition as follows:

Proposed New Rule I—Cigar.

A cigar is a roll of tobacco that:

1. Is wrapped in 100% natural leaf tobacco; or
2. (a) Is wrapped in any substance that contains 75 percent or more tobacco which did not in the reconstitution process lose its tobacco character (taste, aroma, identifiable chemical components) and is of a color consistent with that of the natural leaf tobaccos traditionally used as a wrapper for American cigars; and
- (b) Is not a cigarette within the meaning of [New Rule II].

Proposed New Rule II—Cigarette.

A cigarette is a roll of tobacco that:

1. Is wrapped in paper or any substance not containing tobacco; or
2. Is wrapped in a substance containing tobacco, and is likely to be offered to, or purchased by, consumers as a cigarette. A roll of tobacco wrapped in a substance containing tobacco (other than 100 percent natural tobacco leaf) shall be considered to be likely to be offered to, or purchased by, consumers as a cigarette if any of the following are true:
 - a. It has a cellulose acetate or other integrated filter;
 - b. The tobacco used in the filler contains flue-cured or unfermented tobaccos or has flavor additives;
 - c. The tobacco in the filler, binder, or wrapper contains any sucrose;
 - d. The packaging does not clearly and conspicuously declare that the product is a cigar;
 - e. The appearance, packaging and/or labeling of the product meets three or more of the following criteria:
 - i. The product is sold in packs containing twenty or twenty-five sticks;
 - ii. The product is available for sale in cartons of 10 packs;
 - iii. The product is sold in soft packs, hard packs, flip-top boxes, clam shells, or other cigarette-type boxes;
 - iv. The product weighs less than three pounds per thousand sticks; or
 - v. The product is the diameter and length of a commercially-manufactured cigarette;
 - f. The product is marketed or advertised to consumers as a cigarette or cigarette substitute; or

g. It contains any other indicia that the product fits within the definition of cigarette in 26 U.S.C. 5702(b).

Proposed New Rule III—Procedure.

1. A manufacturer shall request an advance ruling from the bureau as to any product a manufacturer or importer wishes to market as a cigar.

2. The bureau shall make an advance ruling as to whether a product is a cigar within the meaning of 26 U.S.C. 5702(a), using the criteria above and the characteristics of the tobacco product, its packaging and labeling, and the totality of the circumstances.

3. Along with a request for determination, the manufacturer shall submit the following:

- a. The package and any larger consumer container such as the carton, or the detailed graphics for these if they have not been printed;
- b. A statement of the merchandising theme and copies of all advertising that mentions or depicts the product and point of sale merchandising material for the product;
- c. A statement under penalty of perjury that the merchandising and advertising materials submitted are of the exact, actual advertising that will be used in the United States;
- d. A statement under penalty of perjury that the manufacturer will obtain a new ruling from the Bureau if any material modifications are made to the marketing or advertising of the product prior to any change in the existing marketing or advertising;
- e. A statement of composition of the wrapper including the type, geographic origin, treatment, age, and percentage of each tobacco used;
- f. 2,500 square inches (17 square feet) of the wrapper material;
- g. A statement of all the materials, chemicals, and additives and proportion of each used in the binder, and the production process;
- h. 400 sticks of the finished product (if weighing not more than 10 pounds a thousand), or 200 sticks of the finished product (if weighing more than 10 pounds a thousand);
- i. A statement under penalty of perjury of all the materials, chemicals, and additives and proportion of each used in the filler and the production process, including, but not limited to, the proportion of fermented air-cured tobacco, flue-cured tobacco and unfermented tobacco;
- j. A statement under penalty of perjury that the samples submitted are of the exact, actual product that will be sold in the United States; and
- k. A statement under penalty of perjury that the manufacturer will obtain a new ruling from the Bureau if any modifications are made to the composition or ingredients of the product prior to sales of any modified product.

4. If the manufacturer requests a ruling, the manufacturer shall submit all other relevant evidence required to enable the bureau to make a ruling. Pending a ruling by the Bureau, the manufacturer may only sell its product as a cigarette and comply with all laws applicable to cigarettes; such sales may

occur only after the manufacturer notifies the revenue departments of the states where the product will be sold that a ruling by the Bureau is still pending.

5. Not later than January 1, 2007, the Bureau shall develop and publish on its Internet Web site a directory listing of all rulings by the Bureau regarding the classification of a tobacco product as a cigar or as a cigarette, including the name and address of the manufacturer requesting the product classification, the product brand family and if the trademark for the brand family is not owned by the manufacturer, the name and address of the owner of the trademark.

On May 18, 2006, the Assistant Attorney General for the State of Montana, Kelly M. O'Sullivan, submitted an amendment to the petition submitted by the 23 States on April 24, 2006. The amendment was submitted to add an additional 16 States and one territory to the original petition, bringing the supporters of this petition to 39 States and one territory, as follows: Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, Nevada, New Mexico, New Jersey, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin, Wyoming, and Guam.

In addition, the petition amendment included more recent information pertaining to the consumption of little cigars and cigarettes. Specifically, the petition amendment states:

Since the States filed our petition with the TTB, the following official information from the United States government, U.S. Department of Agriculture, Tobacco Outlook has come to our attention. While cigarette consumption has continued to decline, small cigar consumption increased significantly in 2005 over 2004. "Consumption of little cigars reached 4,037 million cigars, compared with 2,917 million in 2004. Popularity of little cigars increased in part due to lower tax rates than cigarettes and because Master Settlement Agreement payments are not assessed on small cigars as they are with cigarettes." [U.S. Dep't of Agriculture, Tobacco Outlook. Wash., DC: U.S. Dep't of Agric., Econ. Res. Serv., 2005, p. 2. The Tobacco Outlook and accompanying tables are available at: usda.mannlib.cornell.edu/reports/ersor/specialty/tbs-bb/2006/tbs260.pdf.] Data compiled from reports of the Bureau of Alcohol, Tobacco and Firearms, and the Bureau of the Census indicate that per capita consumption of small cigars increased from 10.4 small cigars per person in 2003 to 12.1 small cigars in 2004 and 17.2 small cigars in 2005, an increase of 65% since 2003 and an increase of 42% in the most recent year.

The petition amendment concludes with the following statement:

We believe it is obvious that the majority of this astonishing growth is due to the fact that cigarettes are being passed off as "little cigars" and that, absent effective action by this agency, this dangerous and illegal activity will only intensify * * * The States urge the TTB to act now to adopt new rules and regulations that clearly classify as a cigarette through specific, objective criteria, products that are properly a cigarette—namely "any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette." The States also request that TTB adopt policies and procedures for classification which prevent manufacturers from self-classifying their cigarettes as cigars in order to avoid the attendant federal and state regulations, laws, taxes and payments.

The Need for Regulatory Changes

Based on the considerations that led to the total reducing sugars study discussed above, and in light of the uncertainties and other problems outlined in the three petitions summarized above, TTB believes that a pressing need for regulatory improvements exists. TTB notes in this regard that the only extant regulatory standard for distinguishing between cigars and cigarettes consists of the definitions of these terms, which merely repeat the statutory definitions. The only other published source for guidance in this area is ATF Ruling 73–22, which does not have the same force and effect as a regulation.

We also must emphasize that tax administration under the IRC is the only appropriate basis for the regulatory changes proposed in this document. Although the CAA, Lorillard-RJR, and the petitioner States petitions stress the significance of the signing of the Master Settlement Agreement (MSA), in particular regarding the alleged effect of the MSA on the marketing of little cigars, we note that TTB has no jurisdiction to act under the MSA. Similarly, although the petitioner States cited a number of public health issues in their petition, such issues are clearly outside the scope of Chapter 52 of the IRC. Accordingly, the proposed regulatory amendments contained in the document are directed only to enforcing the provisions of Chapter 52 of the IRC.

Basic Interpretative Principles

TTB recognizes that the statutory definitions of "cigar" and "cigarette" are controlling and are not susceptible to modification by regulation. Accordingly, we must operate within those definitions in amending the

regulations to clarify the distinction between cigars and cigarettes for tax purposes. This being said, TTB has authority to interpret those definitions and determine how they are applied to specific products. Several basic interpretations of those definitions underlie the regulatory changes proposed in this document.

One interpretation concerns the effect of the usage of the terms "leaf tobacco" and "substance containing tobacco" in these definitions. It is the position of TTB that a "roll of tobacco" that is wrapped in "leaf tobacco" must be classified as a cigar and never as a cigarette. This position is based on the fact that whereas both definitions include a reference to a "substance containing tobacco" when referring to the wrapper material, the term "leaf tobacco" appears as a wrapper reference only in the "cigar" definition. The terms "leaf tobacco" and "substance containing tobacco" were introduced when the definitions were amended in 1965 (prior to that amendment, the cigar definition referred to a roll of tobacco wrapped in "tobacco" and the cigarette definition referred to a roll of tobacco wrapped in "paper or any substance other than tobacco"). The fact that Congress chose not to use the new wrapper term "leaf tobacco" in the cigarette definition is evidence of an intent to restrict it to a cigar wrapper context.

As a corollary to the rule stated above, a distinction must be made between "leaf tobacco" and a "substance containing tobacco." This is necessary both because the statutory definition of "cigar" uses both terms in the disjunctive (thus making an implicit distinction between them) and because including leaf tobacco within the meaning of "substance containing tobacco" would allow a "cigarette" to have a wrapper consisting of leaf tobacco, contrary to the rule stated above.

Similarly, it is the position of TTB that a "roll of tobacco" that is wrapped in a "substance not containing tobacco" must be classified as a cigarette and never as a cigar. This position is based on two factors: (1) The presence of tobacco in the wrapper (either as "leaf tobacco" or in a "substance containing tobacco") is a prerequisite to classification as a cigar under the cigar definition; and (2) only the first of the two cigarette definitions refers to a "substance not containing tobacco."

Finally, and most important, it is the position of TTB that, in the case of a "roll of tobacco" that is wrapped in a "substance containing tobacco," the statutory definition of "cigar" requires a

threshold determination of whether the product in question is a cigarette; if it is, it must be treated as a cigarette for tax purposes. We note in this regard that a "roll of tobacco" wrapped in a "substance containing tobacco" is potentially classifiable either as a cigar or as a cigarette, because those words are used both in the "cigar" definition and in the second "cigarette" definition. However, the words "other than any roll of tobacco which is a cigarette within the meaning of subsection (b)(2)" in the statutory definition of "cigar" require the reader first to determine whether it is described by the second definition of "cigarette." If it is so described, it must be classified as a cigarette notwithstanding the fact that it also meets the description of a "roll of tobacco * * * wrapped in any substance containing tobacco" contained in the definition of "cigar."

Issues Raised in the Petitions

TTB has carefully reviewed the comments and recommendations made in the three submitted petitions. In addition to our general agreement with all of the petitioners regarding the need for regulatory action to clarify the distinction between cigars and cigarettes, we note the following with regard to the tax-related points made in the petitions.

Creation of an MSA-Based Presumption

TTB does not concur with the Lorillard-RJR petition suggestion to create a (rebuttable) presumption in favor of those little cigar brands marketed prior to the MSA, for two reasons. First, the adoption of such a presumption would give the MSA an inappropriate role in tax classification. As indicated above, TTB's regulatory authority proceeds from the IRC, not the MSA. TTB also agrees with the observation made by the CAA in its response to the Lorillard-RJR petition that such a presumption could lead to confusion, particularly as products move from one category to another or are subjected to a material change in composition or presentation.

Certification for Post-MSA Brands

TTB does not agree with the Lorillard-RJR suggestion to require a one-time certification for post-MSA brands, for the same reason that an MSA-based presumption would not be appropriate. However, TTB does not agree with the CAA assertion that it would be premature to consider the certification concept because it is not known what "test" is to be used. For reasons set forth in more detail below, we believe that, with the adoption of improved,

objective regulatory standards for distinguishing between cigars and cigarettes, a properly designed certification procedure could provide a workable solution for manufacturers, importers, and TTB.

Third Party Challenge Procedure

TTB agrees with the CAA that the third party product classification challenge procedure suggested in the Lorillard-RJR petition would be unworkable. Such a challenge procedure would put TTB in the position of having to mediate a dispute involving private parties, a position that TTB should not occupy. Moreover, any role that TTB might perform in such a dispute would inevitably involve the issue of disclosure of tax return information, which in most cases is prohibited under 26 U.S.C. 6103. We should point out, however, that any person, including a competitor, may refer information to us about a manufacturer's or importer's improperly classified tobacco product.

Coordination With Customs and Border Protection

TTB agrees with the suggestion in the Lorillard-RJR petition regarding coordination with Customs and Border Protection (CBP) on regulatory changes as they affect imported products. We consulted with CBP in connection with the drafting of this document, and we will continue to closely coordinate with CBP on our regulatory and related actions as they relate to import transactions falling under the jurisdiction of CBP.

Proposed New Rules To Define Cigars and Cigarettes

While TTB agrees with the suggestion of the petitioner States that specific new rules are necessary to clarify the distinction between cigars and cigarettes, we do not agree with their proposed new definitions approach, because, as noted above, the IRC definitions control and cannot be changed by regulatory action. Rather, we believe that the proper approach is to set forth specific rules that interpret and apply the IRC definitions for tax classification purposes. The acceptability of the specific rules suggested by the petitioner States is addressed below in the discussion of the proposed regulatory texts set forth in this document.

Proposed Advance Ruling Procedure

TTB is opposed to the new advance ruling procedure proposed by the petitioner States, because this would improperly shift the burden of tax

compliance from the taxpayer to the Government. We believe that the following statement from ATF Ruling 73-22 continues to reflect the proper agency position on this issue:

Manufacturers and importers have the initial responsibility for (1) determining whether material intended for use as a wrapper for rolls of tobacco is a "substance containing tobacco," (2) determining whether a roll of tobacco wrapped in such material has the characteristics of a cigar or a cigarette, (3) knowing whether the product is likely to be offered to or purchased by consumers as a cigar or a cigarette, and (4) paying the tax at the proper rate.

However, we no longer believe that the advance ruling procedure referred to in ATF Ruling 73-22 is the best way to ensure compliance. Rather, we believe that a procedure involving the advance submission of a written tax classification certification to TTB is the best approach because it places the initial responsibility where it lies under the IRC, that is, with the manufacturer or importer. The certification procedure that TTB proposes is discussed in more detail later in this document.

Status of ATF Ruling 73-22 and ATF Procedures 73-5 and 76-2

With the exception of the reference to the advance ruling procedure, TTB is in substantial agreement with the standards and statements contained in ATF Ruling 73-22. However, as noted above, it is preferable to have tax classification standards reflected in the text of a regulation rather than in a guidance document that was not the subject of public notice and comment procedures. Accordingly, we propose to incorporate the substance of ATF Ruling 73-22 in the regulations, with the result that ATF Ruling 73-22 will be superseded in its entirety upon adoption of the proposed regulatory changes as a final rule.

With regard to ATF Procedures 73-5 and 76-2, TTB notes that the tobacco industries in the United States and abroad have changed the way they manufacture and market their products, and this may be especially true for little cigars. As a result of these changes and in view of the technological advances made with regard to the analytical instrumentation used to examine tobacco products, TTB believes it will be necessary to update the analytical standards it uses to evaluate these products. Moreover, the new standards proposed in this document rely in part on the results of the total reducing sugars study discussed above, which requires an analytical approach not covered by the existing Procedures. We are publishing elsewhere in this issue of

the **Federal Register** a notice describing the analytical methodology that TTB uses to determine the total reducing sugar content of tobacco products.

Discussion of the Proposed Amendments

We are proposing to amend parts 40, 41, 44, and 45 to clarify the tax classification of cigars and cigarettes, with particular emphasis on the adoption of standards in the regulations to distinguish between these two classes of products. The proposed amendments, which are essentially the same for each part, involve:

(1) The addition of two new definitions in §§ 40.11, 41.11, 44.11, and 45.11 and, in each current definition of “cigar” and “cigarette,” the inclusion of a cross-reference to the new clarifying classification provisions.

(2) The addition of two new sections in each part (§§ 40.12 and 40.13, 41.12 and 41.13, 44.12 and 44.13, and 45.12 and 45.13), the first one of which in each part sets forth the clarifying classification rules and the second of which requires a cigar manufacturer or importer to submit a classification certification to TTB; and

(3) The addition of a new paragraph (b) setting forth additional notice requirements for cigars in §§ 40.214, 41.73, 44.186, 44.253, and 45.44.

The following specific points are noted regarding the proposed regulatory amendments.

New Definitions

The two new definitions cover two terms, “substance containing tobacco” and “substance not containing tobacco,” the first of which appears in the existing statutory and regulatory definitions of “cigar” and “cigarette” and the second of which is only in the “cigarette” definition. We included both because including only one of them would not in all cases clarify the meaning (scope) of the other defined term. The “substance containing tobacco” definition refers specifically (but not exclusively) to “reconstituted tobacco” based on the significance of this material in this context, as discussed earlier in this document.

The two definitions incorporate the two-thirds rule, rather than the 75 percent standard proposed by the petitioner States (see the description of the two-thirds rule in the discussion of ATF Ruling 73–22 earlier in this preamble). We note in this regard that the two-thirds rule is familiar to the trade and has been the standard since ATF Ruling 73–22 was issued, and our experience since 1973 does not support any change in this standard.

The proposed definitions do not include the additional two criteria in ATF Ruling 73–22 requiring that the reconstituted tobacco not lose its tobacco character (e.g. taste, aroma, identifiable chemical components) and be of a color consistent with that of the natural tobacco leaf tobaccos traditionally used as a wrapper for American cigars. This criterion was also reflected in the superseded Revenue Ruling 69–198 that was issued after the 1965 statutory amendments to the definitions of cigars and cigarettes in order to help implement those changes to the law. TTB believes that these standards are too subjective and should not be included in the proposed definitions, which aim to establish an objective standard.

Finally, the two definitions refer to “leaf or other fibrous material from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*” because the former is the plant most commonly associated with “tobacco” (see, for example, Webster’s Third New International Dictionary of the English Language, unabridged, 1993, Merriam Webster, Inc. Springfield, MA) and because we understand that the latter is also used in tobacco products on a more limited scale.

Classification of Cigars and Cigarettes

The “classification of cigars and cigarettes” section added to each part reflects the classification principles that we outlined earlier in this document. In addition, it incorporates a “3.0 percent by weight of total reducing sugars” standard as a dividing line between the two classes of products, with cigars at or below that level and cigarettes above it. This reflects the results of our total reducing sugar study, which yielded a clear, objective criterion to distinguish between these products that we believe is more complete than the “contains any sucrose” standard for a cigarette suggested by the petitioner States because, as explained earlier, sucrose is captured in the total reducing sugar values disclosed in the study. The proposed standards for classification as a cigarette also incorporate some specific criteria from both the petitioner States petition and ATF Ruling 73–22.

The “cigar certification” section added to each part requires a manufacturer or importer of cigars to have filed with TTB’s National Revenue Center a certification that the product in question meets the rules for classification as a cigar prior to removal of the product. This certification reflects the principle stated in ATF Ruling 73–22, and reaffirmed in this document, that it is the legal obligation of the

taxpayer to initially determine the tax status of a tobacco product. TTB believes that, with the adoption of the classification standards proposed in this document, manufacturers will be in a much better position to do that. Manufacturers will also be able to assess more readily whether a change in the formulation or manufacturing process for their products results in a change in their tax classification. The new section in each case also requires the submission of a new certification if there is a change to a previously certified product.

Notice Requirements for Cigars

Finally, the new paragraph (b) added to the cigar notice requirements in the four parts reflects primarily the terms of ATF Ruling 73–22. These additional notice requirements are intended to ensure that a cigar is fully and clearly marked as such, so that it would not be “likely to be offered to, or purchased by, consumers as a cigarette” within the meaning of the second cigarette definition.

Effective Date Considerations

In addition to soliciting comments on the proposed regulatory text amendments set forth below and on the position of TTB on the issues discussed in the preamble of this document, we invite comments on whether, and if so for what period, a delayed effective date should apply to any final rule action on this matter. Noting in particular the proposed new pre-removal cigar certification procedure, we are interested in knowing whether a delayed effective date would be needed to afford manufacturers and importers sufficient time to obtain all of the facts necessary to execute and file a proper certification.

Public Participation

Comments Sought

TTB requests comments on the proposed amendments to our regulations discussed in this notice from anyone interested. Please submit your comments by the closing date shown above in this notice. Your comments must include this notice number (Notice No. 65) and your name and mailing address. Your comments must be legible and written in language acceptable for public disclosure. We do not acknowledge receipt of comments, and we consider all comments as originals.

Submitting Comments

You may submit comments in one of five ways:

- *Mail:* You may send written comments to TTB at the address listed in the **ADDRESSES** section.

- *Facsimile:* You may submit comments by facsimile transmission to 202-927-8525. Faxed comments must—

- (1) Be on 8.5- by 11-inch paper;

- (2) Contain a legible, written signature; and

- (3) Be no more than five pages long. This limitation assures electronic access to our equipment. We will not accept faxed comments that exceed five pages.

- *E-mail:* You may e-mail comments to nprm@ttb.gov. Comments transmitted by electronic mail must—

- (1) Contain your e-mail address;

- (2) Reference this notice number on the subject line; and

- (3) Be legible when printed on 8.5- by 11-inch paper.

- *Online form:* We provide a comment form with the online copy of this notice on our Web site at http://www.ttb.gov/tobacco/tobacco_rulemaking.shtml. Select the "Send comments via e-mail" link under this notice number.

- *Federal e-rulemaking portal:* To submit comments to us via the Federal e-rulemaking portal, visit <http://www.regulations.gov> and follow the instructions for submitting comments.

You may also write to the Administrator before the comment closing date to ask for a public hearing. The Administrator reserves the right to determine whether to hold a public hearing.

Confidentiality

All submitted material is part of the public record and subject to disclosure. Do not enclose any material in your comments that you consider confidential or inappropriate for public disclosure.

Public Disclosure

You may view copies of this notice, the related rulemaking petitions, and any comments we receive on this proposal by appointment at the TTB Information Resource Center at 1310 G Street, NW., Washington, DC 20220. You may also obtain copies at 20 cents per 8.5- by 11-inch page. Contact the TTB information specialist at the above address or by telephone at 202-927-2400 to schedule an appointment or to request copies of comments.

We will post this notice and any comments we receive on this proposal on the TTB Web site. All name and address information submitted with comments, including e-mail addresses, will be posted. We may omit voluminous attachments or material that we consider unsuitable for posting. In

all cases, the full comment will be available in the TTB Information Resource Center. To access the online copy of this notice and the submitted comments, visit http://www.ttb.gov/tobacco/tobacco_rulemaking.shtml. Select the "View Comments" link under this notice number to view the posted comments.

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget (OMB) for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The current information collections are in §§ 40.214, 44.186, 44.253, and 45.44, which was approved under OMB control number 1513-0101 and included notice requirements for all cigars. The estimated average burden for the current information collections is one hour. The new information collection requirements are in new §§ 40.214(b), 41.73, 44.186(b), 44.253(b), and 45.44(b) and involves notice requirements for all exported cigars and additional notice requirements for all small cigars. This information is required to ensure proper excise payment of taxes on tobacco products. The likely respondents are businesses or other for-profit institutions, including partnerships, associations, and corporations.

The notice information currently required to be displayed on cigar labels is minimal. It is information that is maintained by manufacturers as part of cost and quality control measures. Cigar manufacturers and importers do not expend significant time or expense collecting or providing the notice information. Accordingly, the new collection of information will not result in an increased burden on respondents.

Comments on the collection of information may be sent by e-mail to OMB at Alexander_T._Hunt@omb.eop.gov, or by paper mail to Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503. A copy should also be sent to TTB by any of the methods previously described.

Comments should be submitted within the time frame that comments are due regarding the substance of the regulation.

Comments are invited on: (a) Whether the collections of information are necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the information collection burden; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the information collection burden on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimate of capital or start up costs and costs of operations, maintenance, and purchase of services to provide information.

Regulatory Flexibility Act

Pursuant to the requirements of the Regulatory Flexibility Act (5 U.S.C. chapter 6), we certify that this notice of proposed rulemaking will not have a significant economic impact on a substantial number of small entities. The proposed regulations primarily codify and clarify existing administrative tax classification principles and practices. Accordingly, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code of 1986, we will submit this notice of proposed rulemaking to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Executive Order 12866

This proposed rule is not a significant regulatory action as defined by Executive Order 12866. Therefore, it requires no regulatory analysis.

Drafting Information

The principle author of this document is Linda Wade Chapman, Regulations and Rulings Division, Alcohol and Tobacco Tax and Trade Bureau.

List of Subjects

27 CFR Part 40

Cigars and cigarettes, Claims, Electronic funds transfers, Excise taxes, Imports, Labeling, Packaging and containers, Reporting and recordkeeping requirements, Surety bonds, Tobacco.

27 CFR Part 41

Cigars and cigarettes, Claims, Customs duties and inspection, Electronic funds transfers, Excise taxes, Imports, Labeling, Packaging and containers, Puerto Rico, Reporting and recordkeeping requirements, Surety bonds, Tobacco, Virgin Islands, Warehouses.

27 CFR Part 44

Aircraft, Armed forces, Cigars and cigarettes, Claims, Customs duties and inspection, Excise taxes, Exports, Foreign trade zones, Labeling, Packaging and containers, Reporting and recordkeeping requirements, Surety bonds, Tobacco, Vessels, Warehouses.

27 CFR Part 45

Administrative practice and procedure, Authority delegations (Government agencies), Cigars and cigarettes, Excise taxes, Labeling, Packaging and containers, Reporting and recordkeeping requirements, Tobacco.

Proposed Amendments to the Regulations

For the reasons discussed in the preamble, we propose to amend 27 CFR parts 40, 41, 44, and 45 as set forth below.

PART 40—MANUFACTURE OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES

1. The authority citation for part 40 continues to read as follows:

Authority: 26 U.S.C. 5142, 5143, 5146, 5701, 5703–5705, 5711–5713, 5721–5723, 5731, 5741, 5751, 5753, 5761–5763, 6061, 6065, 6109, 6151, 6301, 6302, 6311, 6313, 6402, 6404, 6423, 6676, 6806, 7011, 7212, 7325, 7342, 7502, 7503, 7606, 7805; 31 U.S.C. 9301, 9303, 9304, 9306.

2. In § 40.11, a new sentence is added at the end of the definition of “Cigar,” a new sentence is added at the end of paragraph (2) in the definition of “Cigarette,” and new definitions of “Substance containing tobacco” and “Substance not containing tobacco” are added in alphabetical order, to read as follows:

§ 40.11 Meaning of terms.

* * * * *

Cigar. * * * For classification rules applicable to cigars, see § 40.12.

Cigarette. * * *

(2) * * * For classification rules applicable to cigarettes, see § 40.12.

* * * * *

Substance containing tobacco.

Reconstituted tobacco sheet or any other material, other than leaf tobacco, at least two-thirds by weight of which consists of tobacco leaf or other fibrous material from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*.

Substance not containing tobacco. Paper or any other material of which less than two-thirds by weight consists of tobacco leaf or other fibrous material

from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*.

* * * * *

3. New §§ 40.12 and 40.13 are added to read as follows:

§ 40.12 Classification of cigars and cigarettes.

The rules set forth in this section control in determining whether a tobacco product is classified as a cigar or as a cigarette for purposes of this part.

(a) *Classification of cigars.* (1)

General. A tobacco product is classified as a cigar if:

- (i) It consists of a roll of tobacco wrapped in leaf tobacco; or
- (ii) It consists of a roll of tobacco that contains no more than 3.0 percent by weight of total reducing sugars and that is wrapped in a substance containing tobacco, and it is not classifiable as a cigarette under paragraph (a)(2) of this section.

(2) *Cigarette classification*

precedence. A tobacco product consisting of a roll of tobacco wrapped in a substance containing tobacco is classified as a cigarette rather than as a cigar if it is described in paragraph (b)(2) or (b)(3) of this section.

(b) *Classification of cigarettes.* A tobacco product is classified as a cigarette if:

- (1) It consists of a roll of tobacco wrapped in paper or in any substance not containing tobacco;
- (2) It consists of a roll of tobacco that contains more than 3.0 percent by weight of total reducing sugars and that is wrapped in a substance containing tobacco; or
- (3) It consists of a roll of tobacco wrapped in a substance containing tobacco; and—

(i) It is put up in a package that bears a product designation or tax classification specified in § 40.215;

(ii) It has a typical cigarette size and shape, has a cellulose acetate or other cigarette-type integrated filter, or is put up in a traditional cigarette-type package that does not bear all of the notice requirements for cigars specified in § 40.214; or

(iii) It has a filler primarily consisting of flue-cured, burley, oriental, or unfermented tobaccos or has a filler material yielding the smoking characteristics of any of those tobaccos.

§ 40.13 Cigar certification.

(a) *Submission.* In the case of a tobacco product classified as a cigar under § 40.12(a)(1)(ii), the manufacturer must have filed a tax classification certification with TTB before removal of the product subject to tax. The manufacturer must sign, date, and file

the certification with the National Revenue Center, Alcohol and Tobacco Tax and Trade Bureau, 550 Main Street, Cincinnati, Ohio 45202. The certification must be in the following form:

I, _____ (name of person executing certification) of _____ (name and address of manufacturer) hereby certify under penalty of perjury that the product designated _____ (brand and style of product) _____ complies with _____ does not comply with (check one) the rules for classification as a cigar set forth in 27 CFR 40.12. _____ (Signature and Date).

(b) *Change in product.* If, after the filing of a certification for a product under paragraph (a) of this section, there is any change in the composition or presentation of that product, the manufacturer must file a new certification that:

- (1) The product complies with the rules for classification as a cigar; or
- (2) The product does not comply with the rules for classification as a cigar.

4. Section 40.214 is revised to read as follows:

§ 40.214 Notice for cigars.

(a) *General.* Before removal subject to tax, every package of cigars shall have adequately imprinted on it, or on a label securely affixed to it:

- (1) The designation “cigars”;
- (2) The quantity of cigars contained in the package; and
- (3) For small cigars, the classification of the product for tax purposes (i.e., either “small” or “little”).

(b) *Additional notice for small cigars.* In addition to the notice required under paragraph (a) of this section, the following notice requirements apply to small cigars put up in a package that is comparable to a traditional cigarette-type package:

(1) The declaration “cigars”, “small cigars”, or “little cigars” must appear in direct conjunction with, parallel to, and in substantially the same conspicuousness of type and background as the brand name each time the brand name appears;

(2) A conspicuous “cigars”, “small cigars”, or “little cigars” declaration must appear on the front, back, and bottom panels of the package even if the brand name does not appear on one or more of these panels; and

(3) A carton containing multiple packages must bear the declaration “cigars”, “small cigars”, or “little cigars” in conjunction with the brand

name and on each panel of the carton that is likely to be visible in a retail sale display.

PART 41—IMPORTATION OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES

5. The authority citation for part 41 continues to read as follows:

Authority: 18 U.S.C. 2342; 26 U.S.C. 5701, 5703, 5704, 5705, 5708, 5712, 5713, 5721–5723, 5741, 5754, 5761–5763, 6301, 6302, 6313, 6404, 7101, 7212, 7342, 7606, 7651, 7652, 7805; 31 U.S.C. 9301, 9303, 9304, 9306.

6. In § 41.11, a new sentence is added at the end of the definition of “Cigar,” a new sentence is added at the end of paragraph (2) in the definition of “Cigarette,” and new definitions of “Substance containing tobacco” and “Substance not containing tobacco” are added in alphabetical order, to read as follows:

§ 41.11 Meaning of terms.

* * * * *

Cigar. * * * For classification rules applicable to cigars, see § 41.12.

Cigarette. * * *

(2) * * * For classification rules applicable to cigarettes, see § 41.12.

* * * * *

Substance containing tobacco.

Reconstituted tobacco sheet or any other material, other than leaf tobacco, at least two-thirds by weight of which consists of tobacco leaf or other fibrous material from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*.

Substance not containing tobacco.

Paper or any other material of which less than two-thirds by weight consists of tobacco leaf or other fibrous material from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*.

* * * * *

7. New §§ 41.12 and 41.13 are added to read as follows:

§ 41.12 Classification of cigars and cigarettes.

The rules set forth in this section control in determining whether a tobacco product is classified as a cigar or as a cigarette for purposes of this part.

(a) Classification of cigars. (1)

General. A tobacco product is classified as a cigar if:

(i) It consists of a roll of tobacco wrapped in leaf tobacco; or

(ii) It consists of a roll of tobacco that contains no more than 3.0 percent by weight of total reducing sugars and that is wrapped in a substance containing tobacco, and it is not classifiable as a cigarette under paragraph (a)(2) of this section.

(2) *Cigarette classification precedence.* A tobacco product

consisting of a roll of tobacco wrapped in a substance containing tobacco is classified as a cigarette rather than as a cigar if it is described in paragraph (b)(2) or (b)(3) of this section.

(b) *Classification of cigarettes.* A tobacco product is classified as a cigarette if:

(1) It consists of a roll of tobacco wrapped in paper or in a substance not containing tobacco;

(2) It consists of a roll of tobacco that contains more than 3.0 percent by weight of total reducing sugars and that is wrapped in a substance containing tobacco; or

(3) It consists of a roll of tobacco wrapped in a substance containing tobacco, and—

(i) It is put up in a package that bears a product designation or tax classification specified in § 41.74;

(ii) It has a typical cigarette size and shape, has a cellulose acetate or other cigarette-type integrated filter, or is put up in a traditional cigarette-type package that does not bear all of the notice requirements for cigars specified in § 41.73; or

(iii) It has a filler primarily consisting of flue-cured, burley, oriental, or unfermented tobaccos or has a filler material yielding the smoking characteristics of any of those tobaccos.

§ 41.13 Cigar certification.

(a) *Submission.* In the case of a tobacco product classified as a cigar under § 41.12(a)(1)(ii), the importer must have filed a tax classification certification with TTB before removal of the product subject to internal revenue tax. The importer must sign, date, and file the certification with the National Revenue Center, Alcohol and Tobacco Tax and Trade Bureau, 550 Main Street, Cincinnati, Ohio 45202. The certification must be in the following form:

I, _____ (name of person executing certification) of _____ (name and address of importer) hereby certify under penalty of perjury that the product designated _____ (brand and style of product) _____ complies with _____ does not comply with (check one) the rules for classification as a cigar set forth in 27 CFR 41.12. _____ (Signature and Date).

(b) *Change in product.* If, after the filing of a certification for a product under paragraph (a) of this section, there is any change in the composition or presentation of that product, the importer must file a new certification that:

(1) The product complies with the rules for classification as a cigar; or

(2) The product does not comply with the rules for classification as a cigar.

8. Section 41.73 is revised to read as follows:

§ 41.73 Notice for cigars.

(a) *General.* Before removal subject to internal revenue tax, every package of cigars, except as provided in § 41.75, shall have adequately imprinted on it, or on a label securely affixed to it:

(1) The designation “cigars”;

(2) The quantity of cigars contained in the package; and

(3) For small cigars, the classification of the product for tax purposes (i.e., either “small” or “little”).

(b) *Additional notice for small cigars.* In addition to the notice required under paragraph (a) of this section, the following notice requirements apply to small cigars put up in a package that is comparable to a traditional cigarette-type package:

(1) The declaration “cigars”, “small cigars”, or “little cigars” must appear in direct conjunction with, parallel to, and in substantially the same conspicuousness of type and background as the brand name each time the brand name appears;

(2) A conspicuous “cigars”, “small cigars”, or “little cigars” declaration must appear on the front, back, and bottom panels of the package even if the brand name does not appear on one or more of these panels; and

(3) A carton containing multiple packages must bear the declaration “cigars”, “small cigars”, or “little cigars” in conjunction with the brand name and on each panel of the carton that is likely to be visible in a retail sale display.

PART 44—EXPORTATION OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES, WITHOUT PAYMENT OF TAX, OR WITH DRAWBACK OF TAX

9. The authority citation for part 44 is revised to read as follows:

Authority: 26 U.S.C. 5142, 5143, 5146, 5701, 5703–5706, 5711–5713, 5721–5723, 5731, 5741, 5751, 5754, 6061, 6065, 6151, 6402, 6404, 6806, 7011, 7212, 7342, 7606, 7805; 31 U.S.C. 9301, 9303, 9304, 9306.

10. In § 44.11, a new sentence is added at the end of the definition of “Cigar,” a new sentence is added at the end of paragraph (b) in the definition of “Cigarette,” and new definitions of “Substance containing tobacco” and “Substance not containing tobacco” are added in alphabetical order, to read as follows:

§ 44.11 Meaning of terms.

* * * * *

Cigar. * * * For classification rules applicable to cigars, see § 44.12.

Cigarette. * * *
(b) * * * For classification rules applicable to cigarettes, see § 44.12.

* * * * *

Substance containing tobacco.

Reconstituted tobacco sheet or any other material, other than leaf tobacco, at least two-thirds by weight of which consists of tobacco leaf or other fibrous material from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*.

Substance not containing tobacco.

Paper or any other material of which less than two-thirds by weight consists of tobacco leaf or other fibrous material from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*.

* * * * *

11. New §§ 44.12 and 44.13 are added to read as follows:

§ 44.12 Classification of cigars and cigarettes.

The rules set forth in this section control in determining whether a tobacco product is classified as a cigar or as a cigarette for purposes of this part.

(a) *Classification of cigars.* (1) *General.* A tobacco product is classified as a cigar if:

(i) It consists of a roll of tobacco wrapped in leaf tobacco; or

(ii) It consists of a roll of tobacco that contains no more than 3.0 percent by weight of total reducing sugars and that is wrapped in a substance containing tobacco, and it is not classifiable as a cigarette under paragraph (a)(2) of this section.

(2) *Cigarette classification precedence.* A tobacco product consisting of a roll of tobacco wrapped in a substance containing tobacco is classified as a cigarette rather than as a cigar if it is described in paragraph (b)(2) or (b)(3) of this section.

(b) *Classification of cigarettes.* A tobacco product is classified as a cigarette if:

(1) It consists of a roll of tobacco wrapped in paper or in any substance not containing tobacco;

(2) It consists of a roll of tobacco that contains more than 3.0 percent by weight of total reducing sugars and that is wrapped in a substance containing tobacco; or

(3) It consists of a roll of tobacco wrapped in a substance containing tobacco, and—

(i) It has a typical cigarette size and shape, has a cellulose acetate or other cigarette-type integrated filter, or is put up in a traditional cigarette-type package that does not bear all of the notice requirements for cigars specified in § 44.186 or § 44.253; or

(ii) It has a filler primarily consisting of flue-cured, burley, oriental, or unfermented tobaccos or has a filler material yielding the smoking characteristics of any of those tobaccos.

§ 44.13 Cigar certification.

(a) *Submission.* In the case of a tobacco product classified as a cigar under § 44.12(a)(1)(ii), the manufacturer must have filed a tax classification certification with TTB before removal. The manufacturer must sign, date, and file the certification with the National Revenue Center, Alcohol and Tobacco Tax and Trade Bureau, 550 Main Street, Cincinnati, Ohio 45202. The certification must be in the following form:

I, _____ (name of person executing certification) of _____ (name and address of manufacturer) hereby certify under penalty of perjury that the product designated _____ (brand and style of product) _____ complies with _____ does not comply with (check one) the rules for classification as a cigar set forth in 27 CFR 44.12.

_____(Signature and Date).

(b) *Change in product.* If, after the filing of a certification for a product under paragraph (a) of this section, there is any change in the composition or presentation of that product, the manufacturer must file a new certification that:

(1) The product complies with the rules for classification as a cigar; or

(2) The product does not comply with the rules for classification as a cigar.

12. Section 44.186 is revised to read as follows:

§ 44.186 Tax classification for cigars.

(a) *General.* Before removal from a factory under this subpart, every package of cigars shall have adequately imprinted on it, or on a label securely affixed to it:

(1) The designation “cigars”;

(2) The quantity of cigars contained in the package; and

(3) For small cigars, the classification of the product for tax purposes; (i.e., either “small” or “little”).

(b) *Additional notice for small cigars.* In addition to the notice required under paragraph (a) of this section, the following notice requirements apply to small cigars put up in a package that is comparable to a traditional cigarette-type package:

(1) The declaration “cigars”, “small cigars”, or “little cigars” must appear in direct conjunction with, parallel to, and in substantially the same conspicuousness of type and background as the brand name each time the brand name appears;

(2) A conspicuous “cigars”, “small cigars”, or “little cigars” declaration must appear on the front, back, and bottom panels of the package even if the brand name does not appear on one or more of these panels; and

(3) A carton containing multiple packages must bear the declaration “cigars”, “small cigars”, or “little cigars” in conjunction with the brand name and on each panel of the carton that is likely to be visible in a retail sale display.

13. Section 44.253 is revised to read as follows:

§ 44.253 Tax classification for cigars.

(a) *General.* Before withdrawal of cigars from a customs warehouse under this subpart, every package of cigars shall have adequately imprinted on it, or on a label securely affixed to it:

(1) The designation “cigars”;

(2) The quantity of cigars contained in the package; and

(3) For small cigars, the classification of the product for tax purposes (i.e., either “small” or “little”).

(b) *Additional notice for small cigars.* In addition to the notice required under paragraph (a) of this section, the following notice requirements apply to small cigars put up in a package that is comparable to a traditional cigarette-type package:

(1) The declaration “cigars”, “small cigars”, or “little cigars” must appear in direct conjunction with, parallel to, and in substantially the same conspicuousness of type and background as the brand name each time the brand name appears;

(2) A conspicuous “cigars”, “small cigars”, or “little cigars” declaration must appear on the front, back, and bottom panels of the package even if the brand name does not appear on one or more of these panels; and

(3) A carton containing multiple packages must bear the declaration “cigars”, “small cigars”, or “little cigars” in conjunction with the brand name and on each panel of the carton that is likely to be visible in a retail sale display.

PART 45—REMOVAL OF TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES, WITHOUT PAYMENT OF TAX, FOR USE OF THE UNITED STATES

14. The authority citation for part 45 continues to read as follows:

Authority: 26 U.S.C. 5703, 5704, 5705, 5723, 5741, 5751, 5762, 5763, 6313, 7212, 7342, 7606, 7805, 44 U.S.C. 3504(h).

15. In § 45.11, a new sentence is added at the end of the definition of

“Cigar,” a new sentence is added at the end of paragraph (2) in the definition of “Cigarette,” and new definitions of “Substance containing tobacco” and “Substance not containing tobacco” are added in alphabetical order, to read as follows:

§ 45.11 Meaning of terms.

* * * * *

Cigar. * * * For classification rules applicable to cigars, see § 45.12.

Cigarette. * * *

(2) * * * For classification rules applicable to cigarettes, see § 45.12.

* * * * *

Substance containing tobacco.

Reconstituted tobacco sheet or any other material, other than leaf tobacco, at least two-thirds by weight of which consists of tobacco leaf or other fibrous material from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*.

Substance not containing tobacco.

Paper or any other material of which less than two-thirds by weight consists of tobacco leaf or other fibrous material from the plant *Nicotiana tabacum* or the plant *Nicotiana rustica*.

* * * * *

16. New §§ 45.12 and 45.13 are added to read as follows:

§ 45.12 Classification of cigars and cigarettes.

The rules set forth in this section control in determining whether a tobacco product is classified as a cigar or as a cigarette for purposes of this part.

(a) *Classification of cigars.* (1)

General. A tobacco product is classified as a cigar if:

(i) It consists of a roll of tobacco wrapped in leaf tobacco; or

(ii) It consists of a roll of tobacco that contains no more than 3.0 percent by weight of total reducing sugars and that is wrapped in a substance containing tobacco, and it is not classifiable as a cigarette under paragraph (a)(2) of this section.

(2) *Cigarette classification precedence.* A tobacco product consisting of a roll of tobacco wrapped in a substance containing tobacco is classified as a cigarette rather than as a cigar if it is described in paragraph (b)(2) or (b)(3) of this section.

(b) *Classification of cigarettes.* A tobacco product is classified as a cigarette if:

(1) It consists of a roll of tobacco wrapped in paper or in any substance not containing tobacco;

(2) It consists of a roll of tobacco that contains more than 3.0 percent by weight of total reducing sugars and that is wrapped in a substance containing tobacco; or

(3) It consists of a roll of tobacco wrapped in a substance containing tobacco, and—

(i) It is put up in a package that bears a product designation or tax classification specified in § 45.45;

(ii) It has a typical cigarette size and shape, has a cellulose acetate or other cigarette-type integrated filter, or is put up in a traditional cigarette-type package that does not bear all of the notice requirements for cigars specified in § 45.44; or

(iii) It has a filler primarily consisting of flue-cured, burley, oriental or unfermented tobaccos or has a filler material yielding the smoking characteristics of any of those tobaccos.

§ 45.13 Cigar certification.

(a) *Submission.* In the case of a tobacco product classified as a cigar under § 45.12(a)(1)(ii), the manufacturer must have filed a tax classification certification with TTB before removal of the product. The manufacturer must sign, date, and file the certification with the National Revenue Center, Alcohol and Tobacco Tax and Trade Bureau, 550 Main Street, Cincinnati, Ohio 45202. The certification must be in the following form:

I, _____ (name of person executing certification) of _____ (name and address of manufacturer) hereby certify under penalty of perjury that the product designated _____ (brand and style of product) _____ complies with _____ does not comply with (check one) the rules for classification as a cigar set forth in 27 CFR 45.12. _____ (Signature and Date).

(b) *Change in product.* If, after the filing of a certification for a product under paragraph (a) of this section, there

is any change in the composition or presentation of that product, the manufacturer must file a new certification that:

(1) The product complies with the rules for classification as a cigar; or

(2) The product does not comply with the rules for classification as a cigar.

17. Section 45.44 is revised to read as follows:

§ 45.44 Notice for cigars.

(a) *General.* Before removal under this part, every package of cigars shall have adequately imprinted on it, or on a label securely affixed to it:

(1) The designation “cigars”;

(2) The quantity of cigars contained in the package; and

(3) For small cigars, the classification of the product for tax purposes (i.e., either “small” or “little”).

(b) *Additional notice for small cigars.* In addition to the notice required under paragraph (a) of this section, the following notice requirements apply to small cigars put up in a package that is comparable to a traditional cigarette-type package:

(1) The declaration “cigars”, “small cigars”, or “little cigars” must appear in direct conjunction with, parallel to, and in substantially the same conspicuousness of type and background as the brand name each time the brand name appears;

(2) A conspicuous “cigars”, “small cigars”, or “little cigars” declaration must appear on the front, back, and bottom panels of the package even if the brand name does not appear on one or more of these panels; and

(3) A carton containing multiple packages must bear the declaration “cigars”, “small cigars”, or “little cigars” in conjunction with the brand name.

Signed: August 3, 2006.

John J. Manfreda,
Administrator.

Approved: September 28, 2006.

Timothy E. Skud,
Deputy Assistant Secretary (Tax, Trade, and Tariff Policy).

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