



March 20, 2007

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Attention: Notice No. 65

I. INTRODUCTION

These comments represent the views of Swedish Match North America ("Swedish Match") and its sister company, General Cigar Co., Inc ("General Cigar"). We are a member and serve on the Board of Directors of the Cigar Association of America ("CAA"). Swedish Match and General Cigar offer the following comments with particular reference to their own product lines of machine made mass market cigars and hand rolled premium cigars.

By way of background, Swedish Match's mass market cigars consist of such notable brands as White Owl and Garcia y Vega, and General Cigar's premium cigar lines include such offerings as Macanudo, Cohiba, Partagas, Punch and Hoyo de Monterrey. Together, the two companies produce in excess of 2,200 stock keeping units ("SKUs").

While we appreciate the TTB's effort to clarify the definition of little/small cigars, we urge the TTB to reconsider broadening the scope of its proposal to include large cigars. Swedish Match and General Cigar contend that the proposed regulations should exclude both machine made mass market and hand rolled premium large cigars for the reasons set forth below, or in the alternative consider modifying the proposed regulations in light of the questions raised and suggestions posited in our comments.

II. LARGE CIGARS SHOULD NOT BE INCLUDED IN THE PROPOSED RULE MAKING.

A. Congressional Intent.

The purpose of the proposed rule making exercise is to enact a bright line test to distinguish between little/small cigars and cigarettes for taxation purposes. As set forth in the TTB's Notice of Proposed Rulemaking, the Proposed Rule is "to provide a clearer and more objective product classification criteria [and]. . .to reduce possible revenue losses through the misclassification of cigarettes and little cigars."

There is no confusion in the market place between large cigars or cigarettes. Neither is a large cigar likely to be offered or purchased by a consumer with the thought that it is a cigarette, nor is it possible for a large cigar to 'masquerade' as a cigarette. Accordingly, since there is no confusion in the market place or within the cigar and cigarette industry at large, Swedish Match and General Cigar assert that large cigars should be excluded from the proposed regulations.

Presently, large cigars are defined as "[a]ny roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco. . .and weighing more than three pounds per thousand." 27 C.F.R. § 40.11. This definitional weight limitation has been the law at least since the Internal Revenue Code of 1954 ("Code") was enacted. Additionally, the Code was amended by the Excise Tax Reduction Act of 1965 to accommodate the development of homogenized tobacco leaf wrappers ("HTL"), because Congress saw the potential for confusion as between "small [little] cigars" and "small [little] cigarettes" and the potential revenue consequences, given the tax rate differential between the two classifications. The Excise Tax Reduction Act of 1965 amended the pre-existing definition of the terms "cigar" and "cigarette" to be complementary, such that a roll of tobacco wrapped in HTL and weighing not more than 3 pounds per thousand would be classified as a cigarette if it met certain conditions specified in the revised definition of "cigarette."

The 1965 amendment to the definition of "cigarette" was designed to preclude the use of HTL to wrap an ordinary (i.e., small) cigarette and misrepresenting it as a little cigar. The definition of "cigar" was amended at the same time to validate the use of HTL on cigars, but with a caveat that made it conform to the amended definition of "cigarette." In short, the caveat was meant to apply only insofar as the alternative definition of cigarette applied. Only those products that fall within the more particularized definition of small cigar or small cigarette are covered. Large cigars over 3 pounds per thousand were never intended by Congress to be covered by the definition.

We further submit that, in the real world, there can be no confusion as between ordinary cigarettes and large cigars (those that weigh more than 3 pounds per thousand) for the simple reason that the 3 pound/thousand limitation is **objective, determinable, and prescribed by statute**. Therefore, Swedish Match and General Cigar urge the TTB to exclude large cigars from the proposed rule making. We further urge the TTB to maintain the current regulations which have been in force and successfully served their

purpose for over fifty years, and if deemed necessary, to codify ATF Ruling 73-22 which cigar manufacturers has relied upon for more than thirty years.

B. Unnecessary Administrative Burden and Cost.

The Proposed Rule contains a self-certification provision for cigar manufacturers (27 C.F.R. § 40.13) that would apply to manufacturers that do not produce any little cigars wrapped in tobacco leaf or HTL. In keeping with our view that large cigars should be excluded from the scope of the Proposed Rule, it would make sense to limit application of the self-certification provision to only manufacturers of little cigars. Applying that requirement to companies that only manufacture large cigars, by contrast, would be entirely unnecessary and, therefore, inappropriate.¹

Even if TTB is deemed to have regulatory authority going beyond the 3 pound/thousand cut off, there is no policy reason for it to do so, since it would place an entirely unnecessary and costly administrative burden on companies such as Swedish Match and General Cigar that do not manufacture or import little cigars or cigarettes. There are no cigarettes that weigh more than 3 pounds per thousand in the U.S. market. Consequently, as a matter of sound administrative or enforcement policy, the scope of the Proposed Rule should be modified to exclude large cigars from coverage. Moreover, the TTB sample on which the reducing sugar test ("RST") was based did not include any samples of large cigarettes weighing more than 3 pounds per thousand. We believe all these policy reasons -- quite apart from the legal constraints discussed above -- are self-evident and compelling.²

As a practical matter, all of Swedish Match's or General Cigar's cigars are classified as large cigars under the current regulations since they weigh greater than three (3) pounds per one thousand (1,000) sticks. Additionally, all of Swedish Match's and General Cigar's cigars would meet the proposed reducing sugar test of 3.0%, and those cigars that have HTL wrappers all have wrappers that contain at least 66.66% tobacco. However, in the event that a large cigar did meet the criteria for a large cigarette, the potential adverse effect could be to reduce the amount of taxes levied on the product from \$48.75 to \$40.95 per 1,000 sticks.

By way of illustration, the taxable removals of cigars in 2005 amounted to 9,052,026,000 cigars. Of those cigars, 43.8% were classified as little cigars under the current regulations. Large cigars generated \$186,496,587.00 in excise tax revenue for fiscal year 2006. Assuming arguendo that the proposed reducing sugar test effectively

¹ We note there is no equivalent requirement for manufacturers of large cigarettes.

² One of the reasons given in support of the state AG's Petition is that states are losing tax revenues because of differences in state tax rates on little cigars and on cigarettes. The question of state tax rates is a matter for state legislatures, rather than an artificial reclassification exercise to achieve an equilibrium between tax rates. In fact, cigarettes and little cigars are taxed at the same rate or higher in the following 20 states, including some the petitioning states: Alaska, Arkansas, California, Colorado, Connecticut, Idaho, Iowa, Minnesota, Mississippi, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, South Carolina, Utah, Vermont, Virginia, Washington State and Tennessee. In addition, a 21st state, Montana, will tax little cigars at the same rate as cigarettes effective July 1, 2007.

reclassifies twenty percent of large cigars as large cigarettes, the net effect could be to reduce the excise taxes collected by the US Treasury on those large cigars by an annual amount of \$7,936,092.22 in tax revenues or \$79,360,922.22 over ten years.³ We do not believe the US Treasury would be in agreement with this unintended result of a decrease in federal excise tax revenue due to the reclassification of large cigars to large cigarettes.

Notwithstanding the fact that the current and proposed definition of cigars also presumes that all 100% tobacco cigars would not be classified as cigarettes, Swedish Match and General Cigar would be required to self certify all of its HTL wrapped cigars at a significant annual cost to the companies. In addition, the two companies would have to devote additional time and financial resources in order to ensure that the tests were appropriately conducted, and the results timely submitted to the TTB. Further, although not clearly specified in the Proposed Rule, since tobacco is an agricultural product, the testing would potentially have to occur more frequently than annually in the event there is a change in the tobacco blend or crop year used in the cigars. The test would have to be re-run in order to verify that the SKU still met the proposed requirements, or the person validating the information and certifying the results to TTB would be at risk of submitting incomplete or false information.

C. Items Requiring Clarification.

The TTB used an Astoria 2 + 2 Flow Analyzer to determine the total reducing sugars in each product. The proposed regulation in the Federal Register, Vol. 71 No. 206 October 25, 2006 page 62509 clearly states that TTB has supplemented the procedures 73-5 and 76-2 with more efficient methodologies. With regard to the analysis of the filler tobaccos used in cigars and cigarettes TTB has adopted an High Performance Anion Exchange Chromatography method using Pulsed Amperometric Detection, which was published in the Journal of Agricultural and Food Chemistry in 1996. This method is less labor intensive and does not require the use of toxic solvents. TTB adopted the Astoria 2 + 2 Flow Analyzer method in response to their assessment of the flow analyzer method used by US manufacturers. It appears from this that TTB is willing to accept data from any scientifically valid method that can reliably provide values that are consistent with the Astoria 2 + 2 method. We would propose that TTB define their method but allow for any scientifically valid and equivalent method to be used to generate the data for certification of cigar status.

Further, there are no provisions that allow cigar manufacturers to solicit certification from the HTL producer/supplier to certify that the HTL is at least 66.6% tobacco and meets the RST test. There is no way for either Swedish Match or General Cigar to test the HTL to determine that it contains greater than 66.6% tobacco. Thus a requirement that allowed for certification by the supplier would be necessary. A requirement of the proposed regulation is that manufacturers provide a certification, under penalty of perjury, to TTB that the items in question meet the requirements for little cigars. In order to accomplish this, the manufacturer must certify that the little cigar

³ This calculation is based on the assumption that both large cigars and large cigarettes are taxed at the highest permissible rate.

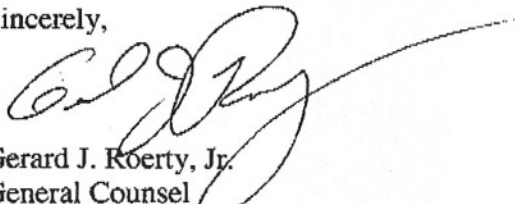
has a total reducing sugar (TRS) content less than or equal to 3.0 percent and that the HTL wrapper is composed of at least 66.66 percent tobacco solids. The manufacturers receive the HTL wrapper from a supplier and have no direct data concerning the composition other than the certification of the supplier. The exact composition of the HTL wrapper material is a trade secret of the supplier and the exact composition, if it were permitted by the confidentiality agreement between the supplier and the manufacturer, would be extremely difficult to accomplish with a high degree of certainty. TTB's examinations of wrapper are eliminated in the proposed new regulation as the examinations and tests are not as decisive as the certification of tobacco solids content and TRS content.⁴

III. CONCLUSION.

Based on the foregoing, Swedish Match and General Cigar respectfully submit that the TTB's proposed regulations should exclude all large cigars, including both machine made mass market and hand rolled premium large cigars.

However, in the alternative should TTB choose to adopt the language set forth in the in the Notice of Proposed Rule Making, Swedish Match and General Cigar submit that the Rules should be modified to: (i) allow for any scientifically valid and equivalent method to be used to generate the data for certification of cigar status of little cigars; and (ii) allow cigar manufacturers to solicit certification from the HTL producer/supplier to certify that the HTL is at least 66.6% tobacco and meets the RST test.

Sincerely,



Gerard J. Koerty, Jr.
General Counsel
Swedish Match North America
General Cigar Co., Inc.

⁴ Nicotine could not be used as a marker as it is far too variable and cellulose is cellulose regardless.