

**Department of Revenue and Taxation
Tobacco Tax**

**Performance Audit
October 1, 2012 through September 30, 2016**

**OPA Report No. 18-04
May 2018**



Department of Revenue and Taxation Tobacco Tax

**Performance Audit
October 1, 2012 through September 30, 2016**

**OPA Report No. 18-04
May 2018**

Distribution:

Governor of Guam
Lt. Governor of Guam
Speaker, 34th Guam Legislature
Senators, 34th Guam Legislature
Department of Revenue and Taxation
Customs and Quarantine Agency
Guam Media via E-Mail



Table of Contents

Executive Summary	1
Introduction	3
Results of Audit	6
Not All Guam Tobacco Wholesalers, Nor Their Tobacco Manufacturers / Distributors, Were Responsive to Our Requests for Information.....	6
Number of Guam-Licensed Tobacco Wholesalers Did Not Match Number of Taxpayers Filing Tobacco Tax.....	7
No Comprehensive, Detailed Data on Tobacco Imports at CQA.....	7
Tax Receivables and Deferred Revenues Not Recorded For Wholesalers Authorized To Delay Tax Payments.....	7
DRT and CQA Do Not Reconcile Tobacco Taxes Reported	8
GTD Forms at CQA Not Updated to Reflect the Correct Tax Rates.....	9
Variances Between Tax Paid and Tax Owed.....	9
Net Underpayments of Tobacco Tax	10
Net Overpayments of Tobacco Tax	10
Potential Effect of Underreporting Tobacco Tax.....	10
Potential Cause If Tax Filings Vary from Imports	10
Other Matters	11
Conclusion and Recommendations	12
Classification of Monetary Amounts	13
Management Response and OPA Reply	14
Appendices:	
1. Objective, Scope, & Methodology.....	17
2. Prior Audit Coverage	19
3. GTD Form with March 2000 Tax Rates	20
4. GTD Form with February 2010 Tax Rates	21
5. DRT Management Response	22
6. Status of Audit Recommendations.....	25



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

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

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

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

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

Insufficient Data to Verify Taxes to Imports

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

Tax Receivables and Deferred Revenues Not Recorded for Authorized Wholesalers

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

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

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

Variance Between Tax Paid and Tax Owed

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

Introduction of the Cigarette Tax Stamp

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

Other Matters

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

Conclusion and Management Response

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

Doris Flores Brooks, CPA, CGFM
Public Auditor



Introduction

This report presents the results of our audit, in which our objective was to determine whether the tobacco taxes reported to the Department of Revenue and Taxation (DRT) for fiscal year (FY) 2013 through FY 2016 corresponded with imports of tobacco products. This audit was initiated as a result of concerns the Office of Public Accountability (OPA) received that tobacco taxes may be underreported.

Refer to Appendices 1 and 2 for the objective, scope, methodology, and prior audit coverage.

Background

Tobacco tax legislation allows the Government of Guam (GovGuam) to know how much tobacco tax should be reported and paid, unlike other business privilege taxes [BPT, more commonly known as gross receipts tax (GRT)]. Pursuant to Title 11 Guam Code Annotated (GCA) Chapter 26 Article 6, tobacco tax collections are supposed to be immediate because tobacco imports are released after tax payments are made. However, 99% of tobacco taxes are not collected immediately because the law allows importers (tobacco wholesalers) to delay tax payment on tobacco products stored in their “warehouse under bond,” as authorized by DRT. These tobacco wholesalers have the advantage of paying their tobacco taxes in the month following the withdrawal of tobacco from these warehouses. The law is silent on the definition and requirements of a “warehouse under bond.”

According to 11 GCA Chapter 26 Article 6, a tobacco tax shall be charged when tobacco products enter Guam’s economy, which is either upon:

- (1) completed production in Guam;
- (2) discharge from its carrier when brought into Guam; or
- (3) purchase for resale, if the tobacco tax had not been paid by the manufacturer or importer.

Tobacco tax is charged and collected from businesses that manufacture or import tobacco products. If tobacco tax was not paid by the wholesaler when the products entered Guam, the tobacco tax will be charged and collected from retailers that purchase the tobacco products for resale in Guam. In addition to cigarettes and cigars, “tobacco products” include the product or manufacture of any of the plant types commonly prepared for smoking, chewing, or snuff (inhaling).

An excise tax is an indirect tax charged on the manufacture, sale, or use of certain types of products, such as cigarettes and alcohol. The excise tax is imposed on the manufacturer or distributor, who then passes the tax on to the consumer by including it in the product's price. Pursuant to BPT Law under 11 GCA Chapter 26, excise taxes are assessed through business returns (e.g., Form GRT-3 for tobacco wholesalers), which are filed with DRT on or before the 20th of the following month the tax was incurred. Each monthly business return should be accompanied by full payment of

taxes due. Even if there is no gross income or tax due to report for the month, the license holder is still required to file a business return.

For this audit report, the terms “manufacturer” and “distributor” may be used interchangeably.

Pursuant to the Tobacco Control Act of 2006 (11 GCA Chapter 6), a wholesale or retail tobacco license must be issued or renewed by DRT to import or sell tobacco products. However, tobacco wholesale licensees cannot hold a tobacco retail license, and vice versa.

Tobacco Tax Collections

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

Table 1 shows the rates applied in computing, charging, and collecting tobacco tax.

Table 1: Tobacco Tax Rates

Tobacco Product	Tax Rate	Per	Measurement Unit
Cigarettes	\$15.00	100	Cigarette
Mini Cigars	\$0.40	1	Cigar
Standard Cigars	\$0.44	1	Cigar
Large Cigars	\$0.50	1	Cigar
Other Cigars (no ring size or length specified)	\$0.44	1	Cigar
Other Tobacco Products	\$40.00	1	Pound (lb.)

Prior to March 2014, Other Tobacco Products were taxed \$26.00 less per pound at \$14.00 per pound.

DRT Memorandum of Understanding with CQA and OAG

In 2002, DRT entered a memorandum of understanding (MOU) with the Guam Customs and Quarantine Agency (CQA) and the Office of the Attorney General (OAG) to minimize the possibility of unreported and untaxed tobacco products entering Guam. After DRT concluded that tobacco products were regularly entering Guam without being taxed, CQA was delegated to collect tobacco taxes before releasing the shipment to the wholesaler. With CQA already assigned to all ports of entry to Guam and authorized to inspect all goods imported through the commercial ports, this delegation intended to make efficient use of governmental personnel and resources.

Before a tobacco shipment is released to the wholesaler, CQA assesses the tobacco tax by having the tobacco wholesaler complete the Guam Tobacco Deposit (GTD) form and pay the full amount due. The GTD form is used to calculate taxes due based on the taxable quantities filled in by the wholesaler. Refer to Appendices 3 or 4.

Shipments released for tobacco wholesalers with a “warehouse under bond” are not dependent on tobacco tax payment. However, CQA must first send to DRT a completed Tracer of Product form (tracer) attached to copies of the tobacco invoice and bill of lading. The tracer is used to authorize storage in the wholesaler’s private “warehouse under bond.”

Both DRT and CQA shall retain records of all tobacco shipments, and OAG maintains and updates the listing of tobacco manufacturers/distributors eligible to sell cigarettes within Guam.

Tax Relief and Drawbacks

Article 6 under BPT Law allows relief from tax liability (exemption), or a drawback (tax refund) on the full amount of tobacco taxes already paid, on tobacco products that were

- exported (sold or consigned) from Guam;
- sold or consigned to any U.S. military concessionaire in Guam;
- sold to licensed concessionaires at the Guam International Air Terminal; or
- destroyed under the Tax Commissioner's supervision because of spoilage.

Healthy Futures Fund

All tobacco taxes are deposited into the Healthy Futures Fund, a special revenue fund for which

- The first \$1M is appropriated annually to assist GMHA's overdue obligations via a line of credit; and
- The balance of the Healthy Futures Fund is allocated as follows:
 - 72% is subject to appropriation for health and education programs relating to tobacco and alcohol prevention, treatment, and control, and to improving overall health and well-being;
 - 15% is transferred into the Guam Cancer Trust Fund;
 - 12% is dedicated to assisting GMHA's operating expenses; and
 - 1% is used to maintain the Guam Cancer Registry.

Results of Audit

We did not receive sufficient evidence to independently verify whether the tobacco taxes reported to DRT for FY 2013 through FY 2016 corresponded with imports of tobacco products.

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

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

Not All Guam Tobacco Wholesalers, Nor Their Tobacco Manufacturers/Distributors, Were Responsive to Our Requests for Information

To independently verify the accuracy of tobacco tax reported and paid to DRT, we attempted to contact the tobacco manufacturers/distributors with whom Guam tobacco wholesalers import from. We requested confirmation on the quantities of cigarettes and other tobacco products brought to Guam during the audit scope. Despite the response time allowed and follow-up letters, not all Guam licensed tobacco wholesalers, nor the tobacco manufacturers/distributors they import from, were responsive.

We learned that several Guam tobacco wholesalers imported from more than one manufacturer/distributor and a few were based outside of the U.S. Some of the non-responsive manufacturers/distributors were just one of several companies with whom a Guam tobacco wholesaler was conducting business with. For instance, one Guam wholesaler may have imported tobacco products from three different manufacturers/distributors, but only two out of three responded to our requests for information.

As such, we did not receive sufficient evidence to independently verify whether the tobacco taxes reported to DRT for FY 2013 through FY 2016 corresponded with imports of tobacco products. However, we observed that CQA and DRT's policies and procedures for assessing tobacco tax provide opportunities for underreporting and fall short of ensuring that all tobacco taxes are paid.

Number of Guam-Licensed Tobacco Wholesalers Did Not Match Number of Taxpayers Filing Tobacco Tax

Based on the business return filings data and list of Guam-licensed tobacco wholesalers provided by DRT, we could not confirm that GRT-3s had been filed by all license holders subject to tobacco tax. In line with DRT's general instructions for filing GRT forms, a tobacco wholesaler must file a GRT-3 form every month even if it does not have any gross income or tax due to report for the period. However, we found that the number of tobacco wholesalers licensed by DRT did not match the number of taxpayers that filed for tobacco tax.

DRT's General Licensing and Registration (Business License) Branch provided a Master List from January 2012 through November 2016, which reported 11 tobacco wholesale license renewals and five cancellations as of December 1, 2016. However, our analysis of the filings data that DRT's Taxpayer Service Division extracted for the same reporting periods indicated that only nine licensees filed tobacco tax returns. DRT maintains its data by tax year (January to December) instead of by fiscal year (October to September), and therefore provided data as close as possible to our audit scope at the time of our request.

No Comprehensive, Detailed Data on Tobacco Imports at CQA

Pursuant to the MOU, both DRT and CQA shall retain records of all tobacco shipments. CQA maintains a log of shipments with the tobacco brands and respective case quantities indicated on the invoices. However, CQA does not maintain a log of the tobacco brands and quantities exported or sold to U.S. military or Guam airport concessionaires. Furthermore, CQA does not maintain a log of the data recorded on the GTD forms. As such, CQA does not maintain comprehensive, detailed data of the tobacco products imported and exported that could be verifiable by DRT.

Tax Receivables and Deferred Revenues Not Recorded for Wholesalers Authorized to Delay Tax Payments

Pursuant to 11 GCA Chapter 26 Article 6, tobacco tax is charged and collected when the products are discharged from its carrier. However, only 1% of imported tobacco was taxed and collected upfront by CQA, while 99% was released to five wholesalers' "warehouses under bond" without immediate assessment and collection of tobacco tax.

The law is silent on the definition and requirements of a "warehouse under bond." DRT has not responded to our requests for information on the requirements and authorization process for a "warehouse under bond." However, we observed that a "warehouse under bond" is essentially a private warehouse with padlock keys under DRT's custody for a separate area controlled by DRT. Based on our site visits to the warehouses, the tobacco was only accessible when a DRT representative was present for the tobacco deliveries and withdrawals. However, we could not verify that DRT had sole custody of all the keys to each padlock.

Upon initial delivery of the tobacco to the warehouse, a DRT representative verifies the quantities stored in the warehouse to the invoice or bill of lading attached to the tracer, but DRT makes no detailed record in its books of the tobacco received, such as quantities, weights, and amount of potential tax receivable. When the wholesaler is ready to withdraw the tobacco, a DRT representative is contacted to unlock the separated area and verify the quantities withdrawn against the withdrawal form provided by the wholesaler. Similarly, DRT makes no detailed record in its

books, such as deferred tax revenue. In addition, DRT does not reconcile the wholesaler's tax filing with the quantities and weights of the tobacco withdrawn from these warehouses.

Unlike other taxable products, DRT can physically inspect taxable tobacco products and know how much tobacco tax should be collected for GovGuam. To better explain the importance of recording the warehouse transactions, we had the DRT representative calculate one month's worth of a wholesaler's tobacco withdrawals against the wholesaler's respective GRT-3 filing. The DRT representative acknowledged the difference in quantities between the GRT-3 filing and the withdrawal forms. With 99% of imported tobacco stored in private warehouses without recording tax receivables and deferred revenues, tobacco tax revenues are assessed and collected like other BPTs. Essentially, DRT has been reliant on the wholesalers' voluntary compliance and self-reporting of tobacco taxes, like other BPTs.

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

Unless DRT can reconcile the number of stamps purchased by the wholesaler to the wholesaler's tax filing, the tax stamp will be like other BPTs that rely on the taxpayer's self-reporting and voluntary compliance with tax laws. However, DRT does not have to rely solely on the tobacco tax information reported by businesses.

We recommend the DRT Director revise the processing of tobacco released to authorized warehouses, to include reconciliation of the wholesaler's GRT-3 filing with the quantities and weights of the tobacco already recorded with the tracer and withdrawal forms, as well as the recording of a tax receivable and deferred revenue.

DRT and CQA Do Not Reconcile Tobacco Taxes Reported

Per the MOU with CQA and OAG, DRT shall ensure that tobacco wholesalers file a business return together with a copy of the paid GTDs; and may request CQA to inspect tobacco shipments from time to time to verify the accuracy of the wholesaler's business return. However, during our walkthroughs, we learned that DRT does not reconcile with CQA the shipments of tobacco products to the tobacco taxes reported.

According to a CQA Officer Supervisor, CQA does not receive any feedback from DRT on the GTD forms it forwards with the tobacco tax payments. Neither does CQA receive any feedback on the tracer forms it transmits to DRT regarding tobacco shipments released to authorized wholesalers.

Part of the DRT representative's responsibility is to inspect the quantities of tobacco stored in and withdrawn from the "warehouses under bond." However, the tracer and withdrawal forms are simply filed away, and the GTD forms are not seen, according to the DRT representative. No tax receivable or deferred revenue is recorded, and no subsequent reconciliation is conducted when the wholesalers file their GRT-3 forms the following month.

With CQA already authorized to inspect all cargo imported and exported through all ports of entry to Guam, the true quantities of taxable tobacco can be calculated, traced, and verified. Likewise, the drawback or tax relief options can be calculated, traced, and verified by CQA or DRT “upon a satisfactory showing” that tobacco was exported, sold to U.S. military or Guam airport concessionaires, or destroyed due to spoilage.

We recommend the Directors of DRT and CQA coordinate and reconcile tax filings to tobacco shipments at least annually.

GTD Forms at CQA Not Updated to Reflect the Correct Tax Rates

In line with the MOU, CQA assesses taxes due on tobacco shipments by having the wholesaler complete the GTD form. During our walkthroughs with CQA, CQA officers shared their uncertainties on whether they were using the most updated GTD form to calculate and collect tobacco taxes. This GTD form does not contain a revision date to assure the CQA officers and tobacco wholesalers that the correct tax rates are applied. The tobacco tax rates reflected in one GTD Form were passed by P.L. 25-104 in March 2000, while the rates reflected in another GTD Form were passed by P.L. 30-80 in February 2010. Refer to Appendices 3 and 4, respectively.

CQA recently encountered a situation in which a wholesaler’s representative presented a check with a higher amount than the tax due calculated on the GTD form. The tax due was based on the February 2010 rate for “other tobacco products” (\$14 per pound), which is \$26 lower than the current rate passed by P.L. 32-132 in February 2014 (\$40 per pound).

To assure CQA officers and the public that the correct tax rates are being applied, we recommended that the DRT Director or designee revise the GTD form to reflect the most recent tax rates and the effective revision date. After our exit conference with DRT and CQA, the CQA Director confirmed that the GTD form was replaced with the GRT-3 form, rendering this recommendation closed.

Variances Between Tax Paid and Tax Owed

In our analysis of the DRT-provided tobacco tax data, we identified what appears to be an underpayment of \$142K by one taxpayer and overpayments ranging from \$2K to \$46K by three taxpayers.

Taxpayer	Net Overpayment (Underpayment)
A	\$ (142,350)
Total Net Underpayments	\$ (142,350)
B	\$ 46,057
C	\$ 33,908
D	\$ 2,444
Total Net Overpayments	\$ 82,409

Another taxpayer's filings for cigarettes reported for December 2013 indicated a negative taxable quantity of 1,258 and no tax paid. If allowed, the exemption exceeding the gross would have resulted in a credit of \$18,870.

Net Underpayments of Tobacco Tax

Taxpayer A's filing for November 2013 indicated that payment was not received for taxes due on cigarettes. We did not see any overpayments in the months preceding and following November 2013, and therefore concluded that Taxpayer A owed \$142K in tobacco taxes as of September 30, 2016.

Net Overpayments of Tobacco Tax

Taxpayer B's filings for cigarettes reported for February and May 2012 indicated underpayments of \$379K and \$360K, respectively. However, for cigarettes reported for July and August 2012, this taxpayer overpaid by \$395K and \$383K, respectively. A review of the months preceding and following July and August 2012, shows these filings may include payments for past due taxes. Furthermore, Taxpayer B's August 2012 filing for cigars (standard) and other tobacco products indicated that the tax rates were doubled, which resulted in overpayments of \$818 for cigars (standard) and \$6K for other tobacco products. The net effect of these variances is overpayments of \$46K.

Taxpayer C's filings for other tobacco products for July and August 2012, indicated that this taxpayer was assessed double the tax rate, or \$28 per pound, for a total overpayment of \$34K.

Taxpayer D's filing for other tobacco products reported for February 2014 was assessed \$15.47 per pound, instead of \$14 per pound, for an overpayment of \$2K.

While not conclusive, these matters were referred to DRT for further review.

Potential Effect of Underreporting Tobacco Tax

If tobacco tax is underreported, the Healthy Futures Fund would be understated, which would deprive Guam of tobacco tax revenues needed annually for:

- Appropriations for health and education programs relating to tobacco and alcohol prevention, treatment, and control, and to improving overall health and well-being;
- Guam Cancer Trust Fund programs supporting cancer screening, treatment, support services, cancer education, and outreach programs;
- Assisting GMHA's overdue obligations and operating expenses; and
- Maintaining the Guam Cancer Registry.

Furthermore, those businesses that diligently apply tax laws with integrity would be unfairly disadvantaged.

Potential Cause If Tax Filings Vary from Imports

Although we did not receive sufficient evidence to answer our audit objective, we explored possible causes of why tax filings would vary from the imports. Tobacco tax legislation, unlike other BPTs, allows DRT to physically inspect taxable tobacco products and know how much

tobacco tax should be collected for GovGuam, therefore, variance in filings and imports can be reconciled as follows:

1. Even when a taxpayer is authorized to delay tax payment, DRT still can reconcile the wholesaler's GRT-3 filing with the quantities and weights of the tobacco already recorded with the tracer and withdrawal forms, and in turn, the ability to record tax receivables and deferred revenues;
2. True quantities of taxable tobacco can be traced and verified, with CQA already authorized to inspect all cargo imported and exported through all ports of entry to Guam; and
3. Eligibility for drawback and tax relief options can be traced and verified by CQA or DRT.

With constraints in obtaining sufficient evidence for independent verification, we referred the concerns of potential underreporting to DRT to further investigate.

Other Matters

The following matters came to our attention during the audit but were not directly related to our audit objective but have an impact on tobacco taxes.

- In July 2015, a CQA officer pled guilty in the U.S. District Court of Guam for accepting bribes from a business owner from approximately 2010 and 2014 in exchange for releasing shipping containers without collecting taxes for the cigarettes contained therein.
- Between FY 2013 and FY 2016, CQA collected \$13K total in tobacco taxes, ranging from \$123 to \$10K annually. However, the Department of Administration (DOA) confirmed that CQA's collections were recognized as "licenses, fees, and permits" revenue, instead of "tobacco tax" revenue affecting the Healthy Futures Fund.
- Potential revenue is further diluted since wholesalers may request a drawback for the full amount paid – and essentially be relieved from tax liability – on the taxes of tobacco products exported to the neighboring islands, sold to U.S. military or Guam airport concessionaires, or destroyed because of spoilage.
- Electronic cigarettes (e-cigarettes) and the liquid nicotine refills are currently assessed the 4% GRT rate, but not tobacco tax.

Conclusion and Recommendations

We did not receive sufficient evidence to independently verify whether the tobacco taxes reported to DRT for FY 2013 through FY 2016 corresponded with imports of tobacco products.

Our audit found that although 11 GCA Chapter 26 Article 6 allows DRT to know how much tax should be reported and paid, unlike other self-reported BPTs, CQA and DRT's policies and procedures for assessing tobacco tax provide opportunities for underreporting and fall short of ensuring that all tobacco taxes are paid. Specifically, we found that:

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

Considering GovGuam's ongoing cash constraints, any improvements to government revenue collections are welcome. Pursuant to tobacco tax legislation, tobacco tax is charged and collected when the products are discharged from its carrier. However, the law allows wholesalers to delay tax payments on the tobacco stored in a "warehouse under bond." While access to the tobacco appeared to be limited to when a DRT representative was present, tobacco products received and withdrawn were not recorded in DRT's books and we could not verify that DRT had sole custody of all the keys to each padlock. Only 1% of imported tobacco was taxed and collected upfront by CQA, while 99% was released to five authorized wholesalers without immediate assessment and collection of tobacco tax.

Due to constraints in obtaining sufficient evidence for independent verification, we referred concerns of potential underreporting to DRT to further investigate. We also made the following recommendations:

- (1) DRT Director to revise the processing of tobacco released to authorized warehouses, to include reconciliation of the wholesaler's GRT-3 filing with the quantities and weights of the tobacco already recorded with the tracer and withdrawal forms, as well as the recording of a tax receivable and deferred revenue;
- (2) Directors of DRT and CQA coordinate and reconcile tax filings to tobacco shipments at least annually; and
- (3) DRT Director to revise the GTD form to reflect the most recent tax rates and the effective revision date.

Classification of Monetary Amounts

	Finding Description	Questioned Costs	Potential Savings	Unrealized Revenue	Other Financial Impact	Total Financial Impact
1.	Number of Guam-Licensed Tobacco Wholesalers Did Not Match Number of Taxpayers Filing Tobacco Tax	\$ -	\$ -	\$ -	\$ -	\$ -
2.	No Comprehensive, Detailed Data on Tobacco Imports at CQA	\$ -	\$ -	\$ -	\$ -	\$ -
3.	Tax Receivables and Deferred Revenues Not Recorded for Wholesalers Authorized to Delay Tax Payments	\$ -	\$ -	\$ -	\$ -	\$ -
4.	DRT and CQA Do Not Reconcile Tobacco Taxes Reported	\$ -	\$ -	\$ -	\$ -	\$ -
5.	GTD Forms at CQA Not Updated to Reflect the Correct Tax Rates	\$ -	\$ -	\$ -	\$ -	\$ -
6.	Variances Between Tax Paid and Tax Owed					
	Net Underpayments of Tobacco Tax	\$ -	\$ -	\$ 142,350	\$ -	\$ 142,350
	Net Overpayments of Tobacco Tax	\$ -	\$ -	\$ -	\$ 82,409	\$ 82,409
	Total	\$ -	\$ -	\$ 142,350	\$ 82,409	\$ 224,759

Management Response and OPA Reply

In April 2018, we provided draft reports to the Directors of DRT and CQA, as well as to the Speaker and Oversight Chairman on Education, Finance and Taxation of the 34th Guam Legislature. In the same month, we met with DRT and CQA's management, as well as with the Oversight Chairman, to discuss the preliminary audit findings, audit recommendations, and our request for DRT to further investigate the concerns OPA received regarding potential underreporting of tobacco tax.

In DRT's management response, the DRT Director generally disagreed with the findings and recommendations identified in OPA's draft report. Specifically,

1. Number of Guam-Licensed Tobacco Wholesalers Did Not Match the Number of Taxpayers Filing Tobacco Tax

DRT Response: DRT emphasized that there was no revenue loss since the two tobacco wholesalers that OPA noted as non-filers paid their tobacco tax at the ports through the GTD forms. DRT did not capture these payments because the GTD forms were sent to DOA only.

OPA Reply: We found that GTD forms are not seen by DRT which can cause these discrepancies. Regularly reconciling tobacco tax filings, business licenses listings, tobacco shipments, and GTD forms would have given management opportunities to identify and correct discrepancies. Also, prior OPA and Department of the Interior Office of Inspector General (DOI-OIG) reports found that DRT did not identify non-filers based on existing data, such as business license renewals. Therefore, the finding remains.

2. No Comprehensive, Detailed Data on Tobacco Imports at CQA

DRT Response: DRT stated it could not locate the 2002 MOU between DRT, CQA, and OAG and was not clear about what detailed data should be maintained.

OPA Reply: We provided DRT a copy of the signed 2002 MOU subsequent to receiving its management response and prior to audit release. Therefore, this finding remains.

3. Tax Receivables and Deferred Revenues Not Recorded for Wholesalers Authorized to Delay Tax Payments

DRT Response: DRT contested this finding stating that tax revenues and deferred revenues have been reported on the BPT form for many years without any material underreporting. They will discuss with DOA the advantages and disadvantages of accrual revenue reporting.

OPA Reply: Based on DRT’s response, we revised our recommendation to reflect their pending discussion with DOA. Tobacco tax should be assessed and collected upfront, unless delayed assessment and payment are otherwise authorized. Recognizing tobacco tax

receivables and deferred revenues allows DRT to know how much should be reported and paid, unlike other BPTs. However, we noted that DRT does not record such data in its books, strictly relying on the taxpayers’ voluntary compliance. Therefore, this finding remains.

4. DRT and CQA Do Not Reconcile Tobacco Taxes Reported

DRT Response: DRT states that tax reporting is the taxpayers’ responsibility and that DRT conducts audits when there appears to be irregularities.

OPA Reply: Until DRT and CQA regularly reconciles, this finding remains.

5. GTD Forms at CQA Not Updated to Reflect the Correct Tax Rates

DRT Response: DRT states that CQA confirmed the replacement of the GTD form with the GRT-3 form.

OPA Reply: DRT instructed CQA to use the GRT-3 form. CQA confirmed that the GRT-3 form is in use effective January 2018 and therefore, the recommendation is considered closed.

6. Potential Cause of Tax Filings Vary from Imports

DRT Response: DRT states there are several reasons why tax filings will vary from imports, such that the filings are dependent on the export, spoilage, and when they report these “incidentals”. For example, a company could import 100 cartons, but 50 cartons could be exported and 10 cartons could be recognized as spoilage, and that these incidentals would not be recognized until months later.

OPA Reply: As the title implies, this section was included to explore possible causes of why tax filings would vary from the imports. While the BPT law allows certain exemptions, such as those provided by DRT in its response, the GRT-3 form requires wholesalers to report gross taxable quantities (separate from exemptions) and to apply for exemptions, which are still subject to DRT’s approval. Hence, this section remains.

In summary, DRT stated that it “has been effective in administering the tobacco tax laws of Guam... DRT continues to identify ways to improve Information Technology to reduce manual processes... DRT is committed to ensuring that the proper taxes are paid and those who are noncompliant are identified and penalized to the full extent of the law.”

Refer to Appendix 5 for DRT’s official response.

Although a draft report was provided to and discussed with CQA, then CQA Director did not provide an official response.

We appreciate the cooperation and assistance from the staff and management of DRT and CQA.

OFFICE OF PUBLIC ACCOUNTABILITY

A handwritten signature in blue ink, appearing to read 'D. Flores Brooks', is positioned above the printed name.

Doris Flores Brooks, CPA, CGFM
Public Auditor

Our audit objective was to determine whether the tobacco taxes reported to DRT corresponded with imports of tobacco products. The scope of our audit included FY 2013 through FY 2016 (or October 1, 2012 through September 30, 2016), and other periods deemed necessary.

Scope Limitation

We attempted to contact tobacco manufacturers/distributors with whom Guam tobacco wholesalers import from to confirm the quantity of cigarettes and other tobacco products brought to Guam during the audit scope. However, we did not receive sufficient evidence needed to draw a conclusion on the audit objective for the following reasons:

- DRT’s data on the number of Guam-licensed tobacco wholesalers did not match the number of taxpayers filing for tobacco tax; and
- Not all Guam-licensed tobacco wholesalers, nor the tobacco manufacturers/distributors they import from, were responsive to our requests for information.

Methodology

To accomplish our objective, we performed the following:

- Reviewed applicable laws, rules and regulations, and policies and procedures pertaining to the filings of tobacco tax.
- Researched and reviewed prior audits and official publications pertaining to tobacco tax.
- Met with key DRT management to obtain an understanding of the administration of tobacco tax.
- Requested from Guam-licensed tobacco wholesalers, the contact information of their tobacco manufacturers/distributors.
- Requested from third-party tobacco manufacturers/distributors, the quantity and weights of tobacco products imported by Guam tobacco wholesalers during the audit scope.
- Obtained and analyzed:
 - DRT data specific to tobacco wholesale license holders.
 - DRT data specific to business return filings of tobacco tax.
 - Government of Guam financial audit figures.
- Conducted walkthroughs with CQA to obtain an understanding of the procedures for processing tobacco shipments.
- Conducted walkthroughs with DRT to obtain an understanding of the procedures for processing tobacco shipments authorized to be stored in “warehouses under bond.”

- Conducted site visits of each DRT-controlled area within the private warehouses of the five authorized wholesalers.

We conducted this performance audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Except for the scope limitation noted above, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix 2:**Prior Audit Coverage**

Independent Financial Audits

GovGuam Single Audit Reports (FY 2013 – FY 2016) – In FY 2013, GovGuam had a material weakness regarding reconciliation issues that impacted the timely distribution of revenue from monthly gross receipts tax, use tax, hotel occupancy tax, liquid fuel tax and automotive surcharges, tobacco tax, and alcoholic beverage tax. According to the audit report, this occurred because the prior point of sale (POS) system was terminated, the newly acquired POS was not interfaced with DRT’s system, and the posting and application of tax collections to the correct revenue accounts was delayed, which resulted in a suspense account being created in the General Fund.

OPA Performance Audits

OPA Report No. 16-06 | GovGuam Limited Gaming Tax and GMHA Trust Fund Fees, August 2016 – The audit determined that DRT’s listing of potential filers subject to limited gaming tax (LGT) and GMHA Trust Fund Fee did not match the listing of actual filers, and DRT made no follow-ups of these potential filers. Without a complete list of licensed gaming entities, the potential revenue loss increases as DRT is unable to determine who should be assessed the LGT and GMHA Trust Fund Fee. The audit noted that DRT should monitor, audit, and send regular non-filing notices at a minimum.

DOI-OIG Evaluation Reports

Guam’s Business Privilege Tax, September 2014 – The evaluation determined that DRT has an incomplete procedure for identifying contractors subject to BPT and uses an incomplete list of Federal contractors when identifying those subject to BPT. One of DOI-OIG’s recommendations was for GovGuam to expand data sources to identify all contractors that may be subject to BPT. The evaluation identified \$414 thousand (K) in taxes Guam would have collected if the contracts were subject to BPT. The report concluded that by failing to address long-standing tax collection deficiencies (such as with BPT), Guam has been deprived of the revenues it desperately needs to fund public education, health, safety, and other programs for its people.

Guam’s Tax Collection Activities, November 2008 – The evaluation found that DRT’s Examination Branch was not attempting to identify taxpayers that fail to file returns; and although DRT’s taxpayer database is not current and complete, it contains older information that could be used to identify potential non-filers. A common finding in a few of DOI-OIG’s prior audits was that DRT did not investigate potential tax violators and non-filers, nor did it use available resources to identify and locate other non-filers. DOI-OIG also found that DRT’s business license clearance process was hampered by the backlog of unprocessed tax returns. While the tax loss associated with each finding could not be determined, the evaluation concluded that at least \$23.5M is being lost each year. DOI-OIG also reminded that the tax collection problems observed have existed for at least two decades and have been reported on in five separate reports by DOI-OIG.

Appendix 3:
GTD Form with March 2000 Tax Rates

FORM GTD	Please attach Triplicate Copy to Form BRM				ORIGINAL <i>Cashier's Copy</i>
	GUAM TOBACCO DEPOSIT FOR TOBACCO TAX RETURN				
NOTICE TO TAXPAYERS FILL IN ALL ITEMS BELOW BEFORE MAKING DEPOSIT					
NAME AND ADDRESS				MONTH & YEAR:	
				EIN or SSN:	
				GRT ACCOUNT NO:	
				FOR USE BY TREASURER OF GUAM	
TYPE OF TOBACCO	TAXABLE QTY	TAX RATE	TAX DUE		
1. Cigarettes		\$0.35 @ 100	\$		
2. Cigars (Mini)		\$0.05 @ Cigar	\$		
3. Cigars (Standard)		\$0.07 @ Cigar	\$		
4. Cigars (Large)		\$0.10 @ Cigar	\$		
5. Cigars (Others)		\$0.07 @ Cigar	\$		
6. Cigars (Prior to March 24, 2000)		40% of Cost	\$		
7. Other Tobacco Products		\$0.35 @ lb	\$		
TOTAL			\$		
<small>After you receive the validated receipt from the Treasurer of Guam, use it in payment of taxes you report on Form BRM to Deputy Commissioner of the Department of Revenue and Taxation. Receipts validated and deposit credited in account of the Department of Revenue and Taxation.</small>					
FORM GTD	Please attach Triplicate Copy to Form BRM				DUPLICATE <i>Taxpayer's Copy</i>
	GUAM TOBACCO DEPOSIT FOR TOBACCO TAX RETURN				
NOTICE TO TAXPAYERS FILL IN ALL ITEMS BELOW BEFORE MAKING DEPOSIT					
NAME AND ADDRESS				MONTH & YEAR:	
				EIN or SSN:	
				GRT ACCOUNT NO:	
				FOR USE BY TREASURER OF GUAM	
TYPE OF TOBACCO	TAXABLE QTY	TAX RATE	TAX DUE		
1. Cigarettes		\$0.35 @ 100	\$		
2. Cigars (Mini)		\$0.05 @ Cigar	\$		
3. Cigars (Standard)		\$0.07 @ Cigar	\$		
4. Cigars (Large)		\$0.10 @ Cigar	\$		
5. Cigars (Others)		\$0.07 @ Cigar	\$		
6. Cigars (Prior to March 24, 2000)		40% of Cost	\$		
7. Other Tobacco Products		\$0.35 @ lb	\$		
TOTAL			\$		
<small>After you receive the validated receipt from the Treasurer of Guam, use it in payment of taxes you report on Form BRM to Deputy Commissioner of the Department of Revenue and Taxation. Receipts validated and deposit credited in account of the Department of Revenue and Taxation.</small>					
FORM GTD	Please attach Triplicate Copy to Form BRM				TRIPLICATE <i>Attach to BRM</i>
	GUAM TOBACCO DEPOSIT FOR TOBACCO TAX RETURN				
NOTICE TO TAXPAYERS FILL IN ALL ITEMS BELOW BEFORE MAKING DEPOSIT					
NAME AND ADDRESS				MONTH & YEAR:	
				EIN or SSN:	
				GRT ACCOUNT NO:	
				FOR USE BY TREASURER OF GUAM	
TYPE OF TOBACCO	TAXABLE QTY	TAX RATE	TAX DUE		
1. Cigarettes		\$0.35 @ 100	\$		
2. Cigars (Mini)		\$0.05 @ Cigar	\$		
3. Cigars (Standard)		\$0.07 @ Cigar	\$		
4. Cigars (Large)		\$0.10 @ Cigar	\$		
5. Cigars (Others)		\$0.07 @ Cigar	\$		
6. Cigars (Prior to March 24, 2000)		40% of Cost	\$		
7. Other Tobacco Products		\$0.35 @ lb	\$		
TOTAL			\$		
<small>After you receive the validated receipt from the Treasurer of Guam, use it in payment of taxes you report on Form BRM to Deputy Commissioner of the Department of Revenue and Taxation. Receipts validated and deposit credited in account of the Department of Revenue and Taxation.</small>					

Appendix 4:
GTD Form with February 2010 Tax Rates

Please attach Triplicate Copy to Form BRM

GTD	GUAM TOBACCO DEPOSIT FOR TOBACCO TAX RETURN	ORIGINAL <i>Cashier's Copy</i>
NOTICE TO EMPLOYERS: FILL IN ALL ITEMS BELOW BEFORE MAKING DEPOSIT		
NAME AND ADDRESS		MONTH & YEAR:
		EIN or SSN:
		GRT ACCOUNT NO:
	TAXABLE QTY	TAX RATE
1. Cigarettes	0	\$15.00 @ 100
2. Cigars (Mini)	0	\$0.40 @ Cigar
3. Cigars (Standard)	0	\$0.44 @ Cigar
4. Cigars (Large)	0	\$0.50 @ Cigar
5. Cigars (Others)	0	\$0.44 @ Cigar
6. Cigars (Prior to March 24, 2000)	0	40% of Cost
7. Other Tobacco Products	0	\$14.00 per lb
TOTAL		

All pay deposits are calculated based on the tax rate in effect on the date of deposit. The tax rate in effect on the date of deposit is the rate in effect on the date of deposit. The tax rate in effect on the date of deposit is the rate in effect on the date of deposit.

Please attach Triplicate Copy to Form BRM

GTD	GUAM TOBACCO DEPOSIT FOR TOBACCO TAX RETURN	DUPLICATE <i>Taxpayer's Copy</i>
NOTICE TO TAXPAYERS: FILL IN ALL ITEMS BELOW BEFORE MAKING DEPOSIT		
NAME AND ADDRESS		MONTH & YEAR:
		EIN or SSN:
		GRT ACCOUNT NO:
	TAXABLE QTY	TAX RATE
1. Cigarettes	0	\$15.00 @ 100
2. Cigars (Mini)	0	\$0.40 @ Cigar
3. Cigars (Standard)	0	\$0.44 @ Cigar
4. Cigars (Large)	0	\$0.50 @ Cigar
5. Cigars (Others)	0	\$0.44 @ Cigar
6. Cigars (Prior to March 24, 2000)	0	40% of Cost
7. Other Tobacco Products	0	\$14.00 per lb
TOTAL		

All pay deposits are calculated based on the tax rate in effect on the date of deposit. The tax rate in effect on the date of deposit is the rate in effect on the date of deposit. The tax rate in effect on the date of deposit is the rate in effect on the date of deposit.

Please attach Triplicate Copy to Form BRM

GTD	GUAM TOBACCO DEPOSIT FOR TOBACCO TAX RETURN	TRIPPLICATE <i>Attach to BRM</i>
NOTICE TO TAXPAYERS: FILL IN ALL ITEMS BELOW BEFORE MAKING DEPOSIT		
NAME AND ADDRESS		MONTH & YEAR:
		EIN or SSN:
		GRT ACCOUNT NO:
	TAXABLE QTY	TAX RATE
1. Cigarettes	0	\$15.00 @ 100
2. Cigars (Mini)	0	\$0.40 @ Cigar
3. Cigars (Standard)	0	\$0.44 @ Cigar
4. Cigars (Large)	0	\$0.50 @ Cigar
5. Cigars (Others)	0	\$0.44 @ Cigar
6. Cigars (Prior to March 24, 2000)	0	40% of Cost
7. Other Tobacco Products	0	\$14.00 per lb
TOTAL		

All pay deposits are calculated based on the tax rate in effect on the date of deposit. The tax rate in effect on the date of deposit is the rate in effect on the date of deposit. The tax rate in effect on the date of deposit is the rate in effect on the date of deposit.

Appendix 5:
DRT Management Response

Page 1 of 3



Dipátamenton Kontribusion yan Adu'ána
DEPARTMENT OF
REVENUE AND TAXATION
GOVERNMENT OF GUAM Gubetnamenton Guåhan

EDDIE BAZA CALYO, Governor Mags'åhñ
RAY S. TENORIO, Lt. Governor Tifente Gubetnadt

JOHN P. CAMACHO, Director
Direktor
MARIE M. BENITO, Deputy Director
Sigundo Direktor

April 30, 2018

Doris Flores Brooks, CPA, CGFM
Public Auditor
Office of Public Accountability
Suite 401, DNA Building
238 Archbishop Flores Street
Hagatna, GU 96910

Re: Tobacco Tax Performance Audit

Buenas yan Saluda Ms. Brooks:

Attached is the Department of Revenue & Taxation's (DRT) response to the audit findings of the Tobacco Tax program. DRT certainly appreciates findings that support our statements of the need for IT improvements and procurement of new technology to improve efficiency. DRT, as with any department or agency, must prioritize its allocation of financial resources to all programs and services. While there will always be the need for potential improvement in any program or entity, it must be made clear that DRT is accountable and responsible for the assessment, compliance enforcement, audit and collection of taxes and fees. These taxes and fees amount to over \$850 million in General Fund revenues. While the audit does not attach dollar amounts to the findings, with the exception of \$12K in misclassified revenues, it should be noted that Tobacco Taxes make up approximately 2% of the total General Fund and Special Fund revenues. As stated in the audit, the audit objective was to "**determine whether tobacco taxes reported to DRT corresponded with imports of tobacco products**". As explained further in the detailed responses, what seemingly would have appeared to be escaped taxes and underreporting, this is not the case.

1. DRT's data on the number of Guam licensed tobacco wholesalers did not match the number of taxpayers filing tobacco tax:

- No revenue loss was incurred. DRT contacted the taxpayers identified for confirmation and it was revealed that the two tobacco wholesalers were paying their tobacco taxes at the ports through the Guam Tobacco Deposit forms (GTD). These payments were made on the GTD taken in by Guam Customs and forwarded to Department of Administration for their disposition. This process was consistent for those wholesalers who do not have a bonded warehouse operation. However, the accounting data was limited to DOA which resulted in DRT not capturing those imports and tax payments for these two non-bonded warehouse taxpayers. The few shipments and cost of taxes (upon importation) are the primary reasons given by these two tobacco wholesalers for not having record with DRT. The intervals between shipments of tobacco products claimed by the two tobacco wholesalers were done once a year.

2. CQA does not maintain comprehensive, detailed data on imported tobacco products that are stored by warehouses controlled by wholesalers.

DRT maintains its commitment to working with CQA and DOA to continue its monitoring and implementation of any improvement as deemed necessary to administer and enforce the tobacco tax laws of Guam. CQA maintains a database. However, the comprehensive and detailed data, referred to in the audit is unclear. The MOU, referred to in the audit states the agreement for CQA to maintain data. It should be noted that DRT was unable to locate the referenced 2002 MOU and is unclear as to requirements for specific types of details or the period covered by the MOU. CQA maintains records however, it may not be in the format stated in this finding.

3. Tax receivables and deferred revenues are not recorded for the imported tobacco products that are stored in warehouses controlled by the wholesalers:

- DRT contests this finding. As mentioned in the exit conference, tax and deferred revenues are reported on the BPT form. This has been the practice for many years and has not resulted in any material underreporting or payment of tobacco taxes. DRT will discuss with DOA the advantages and disadvantages for accrual revenue reporting of the bonded warehouse inventory separate from the Form GRT-3 as thorough monitoring will be needed to adjust for spoilage, off-island sales, etc.

4. DRT and CQA do not reconcile the tobacco taxes reported with the tobacco shipments:

- As with all other taxes, compliance with Tax reporting is the responsibility of the taxpayers. When there appears to be irregularities in an account, DRT conducts audits which require reconciliation of information of taxpayers and CQA records. A task force has been assembled to identify all potential leakages at the port of entry. The objective of this task force is to minimize tax leakages and increase revenue collection particularly for Tobacco Tax and Use Tax.

5. GTD forms at CQA did not have the updated tax rates:

- A non-issue as the GTD form had been replaced with the GRT-3. Earlier this year, DRT communicated to CQA to use Form GRT-3 for those non-bonded wholesalers. On January 28, 2018, a memo from Director McDonald directed the Customs Inspectors to use GRT-3 to report all tobacco payments.

DRT response to the additional categories listed on the audit report:

- **Potential effect of underreporting tobacco tax,**
 - As in every business, underreporting is always a potential. DRT stands by its mission for the tax paying public to voluntarily comply. The department has the obligation to audit or conduct a criminal investigation on those that are not compliant.

- **Potential cause if tax filings vary from imports,**
 - This statement is a very broad. There are several reasons why tax filings will vary from imports. It's dependent on the export, the spoilage and when they report these incidentals. Although an import could be reported at 100 cartons, 50 could be exports while 10 is spoilage. Then the reporting of these incidentals is not recognized until months later but the company and DRT records will indicate these transactions.

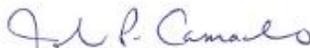
- **\$12,745 in revenue misclassified as licenses, fees, and permits, instead of tobacco tax.**
 - Although nominal in value, DRT is primarily concerned with the continued misclassification and eventual significance this will be in multiples. The task force and ongoing training with CQA will eliminate this issue.

- **Other matters (potential dilution of revenue, e-cigarette neglect).**
 - DRT realizes the importance of all tobacco-related programs and will continue to prioritize as needed.

DRT has been effective in administering the tobacco tax laws of Guam, alongside with CQA. DRT continues to identify ways to improve Information Technology to reduce manual processes and eventually automate and share information with other critical agencies. DRT is committed to ensuring that the proper taxes are paid and those who are noncompliant are identified and penalized to the full extent of the law.

If you have any questions, please email me at john.camacho@revtax.guam.gov or contact me at 635-1815.

Senseramente,


JOHN P. CAMACHO
Director

Appendix 6:**Status of Audit Recommendations**

No.	Addressee	Audit Recommendation	Status	Action Required
1.	DRT Director	Revise the processing of tobacco released to authorized warehouses, to include reconciliation of the wholesaler's GRT-3 filing with the quantities and weights of the tobacco already recorded with the tracer and withdrawal forms, as well as the recording of a tax receivable and deferred revenue;	OPEN	Please provide target date and title of designee responsible for implementing the recommendation.
2.	DRT Director and CQA Director	Coordinate and reconcile tax filings to tobacco shipments at least annually.	OPEN	Please provide target date and title of designee responsible for implementing the recommendation.
3.	DRT Director	Revise the GTD form to reflect the most recent tax rates and the effective revision date.	CLOSED	Please provide target date and title of designee responsible for implementing the recommendation.



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

ACKNOWLEDGEMENTS

Key contributions to this report were made by:
Michele Brillante, Auditor-In-Charge
Rodalyn Gerardo, CIA, CGFM, CPA, CGAP, CGMA, Audit Supervisor
Doris Flores Brooks, CPA, CGFM, Public Auditor

MISSION STATEMENT

**To ensure the public trust and assure good governance,
we conduct audits and administer procurement appeals,
independently, impartially, and with integrity.**

VISION

**The Government of Guam is the model for good governance in the Pacific.
OPA is a model robust audit office.**

CORE VALUES

**Objectivity: To have an independent and impartial mind.
Professionalism: To adhere to ethical and professional standards.
Accountability: To be responsible and transparent in our actions.**

REPORTING FRAUD, WASTE, AND ABUSE

- **Call our HOTLINE at 47AUDIT (472-8348)**
- **Visit our website at www.opaguam.org**
- **Call our office at 475-0390**
- **Fax our office at 472-7951**
- **Visit us at Suite 401, DNA Building in Hagåtña**

All information will be held in strict confidence.