



OFFICE OF PUBLIC ACCOUNTABILITY

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Public Auditor Calls for Repeal of Tobacco Tax Provision

Repeal Will Improve Collections and Promote Fairness to Wholesalers

June 13, 2019

Hagåtña, Guam – On Thursday, June 13, 2019, Public Auditor Benjamin J.F. Cruz sent a letter to Senator Sabina Perez, Chairperson on the Committee on Environment, Revenue and Taxation, and Procurement, calling for the repeal of the tobacco tax provision requiring bonded warehouses. By repealing this provision, tobacco tax collections will improve and fairness will be promoted amongst the island’s five tobacco wholesalers.

According to Title 11, Chapter 26, Article 6, when tobacco products are discharged from its shipment, a tax is charged and collected. The law allows tobacco wholesalers to delay tax payments on its products until after they are discharged from their bonded warehouse. However, in order for the wholesalers to store or withdraw from their bonded warehouse, they need to do it in the presence of an employee of the Department of Revenue and Taxation. In OPA Report 18-04, *Department of Revenue and Taxation Tobacco Tax*, our audit found that DRT was not assessing the tobacco tax during the storage and withdrawal of the tobacco. DRT was also not verifying the wholesalers tax filings against the withdrawal from the warehouse.

*“In light of recent headlines pertaining to the Department of Revenue and Taxation’s staffing, technology needs, and tax collection efforts, I think it is an opportune time to review and repeal the provisions of the law requiring bonded warehouses. By repealing the need for a bonded warehouse, we could improve tobacco tax collections by taxing **ALL** tobacco products when they arrive on our shores. This would eliminate the need for DRT employees to verify what comes in and out of the bonded warehouse and free them up to pursue other priorities of the agency,”* remarked Public Auditor Cruz.



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Honorable Sabina E. Perez
Senator
35th Guam Legislature
Terlaje Professional Building
194 Hernan Cortes Avenue, 1st Fl.
Hagåtña, Guam 96910

Subject: Recommendation to Repeal the Provision of “Warehouses under Bond” or “Bonded Warehouses” from All Laws Concerning Tobacco Tax

Dear Senator Perez:

As the Public Auditor of Guam, I submit this recommendation to repeal the provision of the “warehouse under bond” or “bonded warehouse” as they concern tobacco tax under Title 11 of the Guam Code Annotated (GCA) Chapter 26 Article 6, 11 GCA Chapter 6, and all other laws concerning tobacco tax. I believe repealing the provision of the bonded warehouse will improve tobacco tax collections and promote fairness among the tobacco wholesalers.

Tobacco Wholesalers Benefit from Tax Payment Deferral at Expense of DRT Staff Hours

Pursuant to 11 GCA Chapter 26 Article 6, *Tobacco Tax*, when tobacco products are discharged from its shipment, a tobacco tax is charged and collected. In other words, **before** the Guam Customs and Quarantine Agency (CQA) can release a tobacco wholesaler’s cargo, the wholesaler must first pay the tobacco taxes on its tobacco imports. On or before the 20th of the following month, the same tobacco wholesaler must file a monthly tax return (Form GRT-3).

In addition, the law allows tobacco wholesalers to delay tax payments on the tobacco products it stores in a bonded warehouse. A tobacco wholesaler with an authorized bonded warehouse may delay its tobacco tax payment and GRT-3 filing until the 20th of the following month **after** the tobacco products were released by CQA **and** withdrawn from the bonded warehouse.

The law and the Department of Revenue and Taxation (DRT) are silent on the definition and requirements of a bonded warehouse. In OPA Report No. 18-04, *Department of Revenue and Taxation Tobacco Tax*, we observed that a bonded warehouse was simply an area within the wholesaler’s warehouse isolated and caged off with padlock keys purportedly under DRT’s sole custody. When the wholesaler needs to store or withdraw tobacco from this bonded area, it must do so with the presence of and verification by one employee from DRT’s Business Privilege Tax (BPT) branch.

Office of Senator
SABINA FLORES PEREZ

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For at least one authorized wholesaler, the BPT representative would be called five to six times a month to access the bonded warehouse. The representative would spend from three hours to an entire workday overseeing the movement of tobacco to and from the warehouse. During our audit, five tobacco wholesalers had bonded warehouses. The tobacco tax reported by these five wholesalers accounted for 99% (or \$76.4 million) of the tobacco tax due between fiscal years 2013 and 2016.

Despite the law allowing tax payment deferral and DRT staff hours spent on these bonded warehouses, DRT was not assessing tobacco tax during the storage and withdrawal of the tobacco. Nor was DRT verifying the wholesaler's GRT-3 filing against the withdrawal of tobacco from the warehouse. Essentially, DRT had been relying on the wholesalers' voluntary compliance and self-reporting of tobacco taxes.

More DRT Staff Hours Allocated to Ensure That All Tobacco Is Reported

In OPA Report No. 18-04, we recommended the DRT Director to revise the processing of tobacco stored in bonded warehouses in ways that would ensure all imported tobacco products are reported to DRT.

According to DRT, they made improvements to the processing of tobacco stored in bonded warehouses, including the following:

- Monthly inventory, conducted at the beginning of each month, is enforced to determine the accuracy of the remaining inventory in the private bonded warehouse after the previous month's storage and withdrawal activities.
- An employee from DRT's Compliance (or Alcoholic Beverage Control) branch is required to accompany the BPT representative on any site visits to the bonded warehouses.

We acknowledge that these may help ensure that all storage and withdrawal of tobacco products are reported to DRT. However, the aforementioned improvements require that more DRT staff hours be allocated to a provision with undetermined benefits to the Government of Guam.

Cigarette Stamp Tax Law Also Recognizes Bonded Warehouse Provision

The 34th Guam Legislature acknowledged that the current system of taxing cigarettes relies on voluntary compliance, which unfairly benefits those tobacco wholesalers that do not comply with the law. As such, the 34th Guam Legislature enacted a cigarette tax stamp, under 11 GCA Chapter 6 Article 7, *Cigarette Stamp Tax Law*, with the intent to improve tobacco tax collections and promote fairness for businesses that comply with Guam's laws.

Though not yet implemented, the *Cigarette Stamp Tax Law* continues to recognize the provision of a bonded warehouse deferring tax payments.

Millions in Unreported and Unpaid Tobacco Taxes

Out of five tobacco wholesalers with a bonded warehouse, we are aware of two wholesalers who amassed substantial amounts of unpaid tobacco tax spanning several years. This was despite the benefit that only five wholesalers had of delaying the payment of such taxes.

In July 2018, news media outlets brought to our attention a June 2017 tax lien filed in the District Court of Guam against a tobacco wholesaler for \$14.7 million of unpaid tobacco taxes, penalties, and interest accumulated from April 2014 through March 2017.

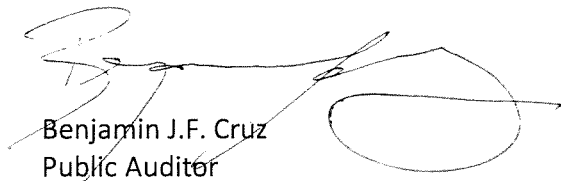
In March 2019, news media outlets reported on a District Court of Guam lawsuit by a whistleblower against DRT, concerning an unreported and unpaid liability of \$13 million in tobacco taxes. The news also referenced an August 2018 letter in which DRT revoked the tobacco wholesaler's business license and certification to operate a bonded warehouse for tobacco, because of the wholesaler's failure to make full payments on the outstanding tobacco taxes, interest, and penalties. DRT confirmed that this wholesaler is different from the wholesaler with a \$14.7 million tax lien.

No Laws, Regulations, or Official Policies on the Certification and Compliance of Bonded Warehouses

The law is silent on the definition and requirements to be a certified or registered bonded warehouse for tobacco products. Meanwhile, DRT has been certifying and cooperating with bonded warehouses without any official policies or standard operating procedures in place.

The Office of Public Accountability has an ongoing audit pertaining to the bonded warehouses for tobacco products. However, given the aforementioned issues and considering the associated administrative and opportunity costs of delaying tax payments to the Government of Guam, I recommend that the Guam Legislature repeal the provision of the bonded warehouse from all laws concerning tobacco tax.

Senseramente,



Benjamin J.F. Cruz
Public Auditor

CC: Honorable Tina Muña Barnes, Speaker, 35th Guam Legislature
All Senators, 35th Guam Legislature