



Cigarette-making Machines in Retail Establishments

TTB has been asked whether a proprietor of a retail establishment who maintains on its premises a commercial cigarette-making machine for use by customers is considered a manufacturer of tobacco products under the Internal Revenue Code of 1986 (IRC), as amended, and, if so, whether the proprietor would have to qualify for and obtain a permit from TTB to engage in that business. For the reasons outlined below, we have determined that such a proprietor is a manufacturer of tobacco products and is therefore subject to the permit requirements of the IRC.

TTB RUL. 2010-4

Background

The Alcohol and Tobacco Tax and Trade Bureau (TTB) has gathered information from a variety of sources and reviewed several scenarios involving commercial cigarette-making machines being used in retail establishments. In general, we understand the circumstances surrounding the use of these machines are as follows:

- The customer enters the store and pays the store clerk for 200 cigarettes, the equivalent of a carton. Such cigarettes are typically referred to as “roll-your-own cigarettes” or “RYO cigarettes.” The customer is provided with loose tobacco, typically from a bin, and cigarette tubes. With or without assistance from a store clerk, the customer inputs the loose tobacco and cigarette tubes into the cigarette-making machine, following prompts that appear on the machine’s computer screen display. The machine outputs cigarettes into a bin or plastic bag.
- The retailer may lease the machine, or may own it outright. Under the provisions of one lease agreement reviewed by TTB, the machine must produce a minimum volume of cigarettes a month, the retailer must charge the customer a specified price per “carton” of cigarettes, and the retailer must provide a full-time employee dedicated to assisting customers with the operation of the machine. The retailer is paid a specified amount per day for maintaining the machine on its premises in accordance with the contract.

- According to Internet advertising by one producer of machines that TTB has seen operated in retail establishments, such a machine can produce one carton of cigarettes in 8 minutes, using 8 ounces of tobacco. That producer describes a retail profit potential based on an average of 50 cartons of cigarettes over a 10-hour period.
- We have found retailers selling cigarettes produced by these machines at prices ranging from \$16.02 to \$25.50 per carton. For reference, the Federal excise tax liability on 200 cigarettes is \$10.066 per 200 (at \$50.33 per 1,000), while the tax on 8 ounces of roll-your-own tobacco is \$12.39 (at \$24.78 per pound).

At least in one instance, a proprietor of such a retail establishment has asserted that the proprietor is not a manufacturer of tobacco products because the proprietor only sells the cigarette-making materials and provides customers with access to the machine. That proprietor has also stated that "pipe tobacco" is used in the machines. TTB has also been approached by individuals interested in purchasing untaxed processed tobacco from manufacturers of processed tobacco and reselling that tobacco to retailers for use in the machines. We note that pipe tobacco is subject to a Federal excise tax rate much lower than that applicable to roll-your-own tobacco and that processed tobacco is not subject to Federal excise tax.

Statutory Provisions

Under the IRC, a Federal excise tax is imposed on tobacco products manufactured in the United States. The manufacturer is liable for such tax. (26 U.S.C. 5701 and 5703)

The term "manufacturer of tobacco products" is defined at 26 U.S.C. 5702(d) to mean any person who manufactures cigars, cigarettes, smokeless tobacco, pipe tobacco or roll-your-own tobacco, but does not include a person who produces cigars, cigarettes, smokeless tobacco, pipe tobacco, or roll-your-own tobacco solely for the person's own personal consumption or use. (This last provision may be described as a "personal use exception.")

Every person, before commencing business as a manufacturer of tobacco products, must apply for a permit to engage in such business and file a bond. A person shall not engage in business as a manufacturer of tobacco products without a permit to engage in such business. (26 U.S.C. 5711, 5712, 5713 and 27 CFR part 40 of the TTB regulations implementing those IRC provisions)

Manufacturers of tobacco products are required to keep records, submit reports, and take inventories of tobacco products. (26 U.S.C. 5721, 5722, and 5741 and 27 CFR part 40)

These records are subject to TTB audit and the premises of a tobacco products manufacturer are subject to inspection. Failure to comply with the recordkeeping requirements may result in the suspension or revocation of the permit or other enforcement actions. Finally, the tobacco products that are manufactured must be put up in packages that must bear required marks and labels. (26 U.S.C. 5713, 5723, 5761, 5762, and 7606 and 27 CFR part 40)

TTB Determination

In general, under the IRC, a cigarette is manufactured when tobacco is formed into a roll and wrapped in paper, or in any substance not containing tobacco.¹ A person who is in the business of making cigarettes for others, or who facilitates the making of cigarettes by or for others by providing the use of a commercial cigarette-making machine at its premises is engaged in the business of a tobacco products manufacturer. The permit requirement is triggered by the manufacture of a cigarette by the commercial cigarette-making machine, which forms the tobacco into the roll and applies the cigarette paper or tube. The permit requirement is triggered regardless of whether the person operating the machine, by inputting loose tobacco and cigarette tubes, is an employee of the retail establishment or the ultimate consumer of the cigarettes manufactured.

The personal use exception in the manufacturer definition does not extend to the use of commercial cigarette-making machines as described above, as it is the machine that manufactures the cigarettes, not the consumer, and the ultimate control of that machine is not with the consumer but rather with the retailer who makes the machine available for use. The retailer, who controls access to and use of such a machine, is the manufacturer of the cigarettes, which are produced not for his or her own consumption but rather for sale in essentially the same manner as a traditional manufacturer of tobacco products. That is, that the commercial cigarette-making machine yields the same result, as a whole, that is generally reached at a permitted manufacturing facility. In such a circumstance as described above, in return for payment for a carton of cigarettes, the customer receives from the retailer 200 commercially-manufactured cigarettes that are not physically distinguishable from other mass-produced cigarettes.

We do not believe that Congress intended for a consumer to be able to purchase at retail commercially-manufactured cigarettes upon which tax has not been appropriately paid. We also do not believe Congress intended to authorize a commercial cigarette-manufacturing operation to occur on premises not subject to Federal regulation.

¹ Under 26 U.S.C. 5702(b), the term “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).“

This determination by TTB is consistent with the long-held position of TTB and its predecessor agencies that cigar rollers (persons who hand-roll cigars for customers) that operate even in a retail store must obtain a TTB permit as a manufacturer of tobacco products.

Finally, we add that the scenarios we have observed involving the use of these machines in retail establishments demonstrate a potential jeopardy to the revenue. We believe that all of the circumstances described in this ruling have been structured so that the consumer is purchasing a carton of commercially-manufactured cigarettes without the appropriate payment of tax. The substance of the business operation, rather than the form, determines whether the proprietor of the retail establishment is a manufacturer.

Held: The proprietor of a retail establishment who is in the business of making cigarettes for others, or who facilitates the making of cigarettes by or for others by providing the use of a commercial cigarette-making machine at its premises is engaged in the business of a tobacco products manufacturer and must qualify for and obtain a permit from TTB to engage in such business. The proprietor must also obtain a bond and comply with the applicable regulatory recordkeeping, reporting, and inventory requirements. As a manufacturer of tobacco products, the proprietor is liable for the payment of tax on the cigarettes produced. Once qualified as a manufacturer of tobacco products, a proprietor may, under the IRC, obtain roll-your-own tobacco and cigarette papers or tubes without payment of tax for use in the manufacture of cigarettes.

Date signed: September 30, 2010.

Signed by John J. Manfreda

John J. Manfreda
Administrator
Alcohol and Tobacco Tax and Trade Bureau