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4/15/79
110803

REPORT BY THE

Comptroller General

OF THE UNITED STATES

U.S. Customs Service Misclassifies Tobacco Imports

Increases in the volume of imported tobacco prompted Senators Helms and Huddleston and Representative Walter B. Jones to ask GAO to review the U.S. Customs Service's classification of tobacco imports.

GAO found that Customs misclassifies tobacco strips as scrap tobacco. The strips, used in manufacturing cigars and cigarettes, should be classified as stemmed cigar or cigarette leaf. Had the strips been properly classified, as much as \$188 million in additional import duties might have been collected over the last 10 years.

Although Customs has been petitioned to change its scrap classification, the outcome is uncertain and legislation may be needed.



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GGD-80-19
NOVEMBER 6, 1979



COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

B-114898

The Honorable Jesse Helms
The Honorable Walter D. Huddleston
United States Senate
The Honorable Walter B. Jones RSN00001
House of Representatives GHS00001

This report concludes that imported tobacco which has had the stem removed and the leaf intentionally broken into pieces is incorrectly classified by Customs as scrap tobacco. This tobacco has been processed into strips for use in the manufacture of cigars and cigarettes, and should be classified as stemmed cigar or cigarette filler leaf tobacco, dutiable at 23 cents and 45 cents per pound respectively, and not as scrap dutiable at 16 cents per pound.

Although parties interested in commenting on an American manufacturer's petition requesting Customs to change its scrap classification for threshed leaf tobacco must make their views known by November 27, 1979, Customs' decision on this matter may not be made for quite some time; and the issue may end up in the courts. Because of these circumstances, legislation clearly setting forth congressional wishes on tobacco classification may be a quicker means of settling the matter. However, the fault lies with Customs' interpretation of the Tariff Schedules, rather than the schedules themselves.

We performed this review in response to the Senators' joint letter of October 13, 1978, and Representative Jones' October 20, 1978, letter. At your offices' request, we did not take the additional time needed to obtain written comments on this report, but the technical aspects of our study were discussed with agency officials.

As arranged with your offices, copies of this report will be sent 3 days from the date of the report to the Director, Office of Management and Budget; the Secretary of the Treasury; and the Commissioner, U.S. Customs Service. Copies will also be available to other interested parties who request them.

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Frederic B. Staats

Comptroller General
of the United States

Tariffs
Customs administration
Tobacco grading
Tobacco industry

D I G E S T

Imported tobacco that has been processed into strips for use in the manufacture of cigars and cigarettes is incorrectly classified by the U.S. Customs Service as scrap tobacco. The tobacco strips are in fact the principal output of a threshing process and should be classified as stemmed cigar or cigarette filler leaf tobacco. Since these tariff classifications carry higher duty rates than scrap tobacco, as much as \$188 million in import duties may have been lost in the last 10 years. Customs' use of the scrap classification likely has been a factor in the doubling of tobacco scrap imports during this period.

The increases in the volume of imported tobacco prompted Senators Helms and Huddleston and Representative Walter B. Jones to ask GAO to review the U.S. Customs Service's classification of tobacco imports.

WHY TOBACCO STRIPS ARE NOT SCRAP

The genesis of the term scrap tobacco predates 1909, when the term first appeared in the Tariff Schedules of the United States. Before then, various judicial decisions were rendered on how scrap tobacco should be dutied, if at all, in the absence of a scrap classification in the tariff schedules. The definition of scrap was not an issue; the decisions agreed that scrap tobacco was small particles broken from the leaves in handling, manufacturing cigars, or removing the stem from leaves.

GGD-80-19

To forestall further litigation on how scrap tobacco should be dutied, a special provision for scrap was put into the tariff schedule of 1909.

The court decisions remain consistent with the current understanding of the term scrap tobacco. For example, Webster's Third New International Dictionary and the Tobacco Dictionary (Philosophical Library, New York, 1954) define scrap as a by-product of the handling of tobacco materials which accumulate in the manufacturing process. Within the industry today, the term scrap tobacco continues to apply to small leaf fragments.

In contrast, tobacco strips are the main product of the machine threshing process and are in an advanced stage of completion for use in the manufacture of cigars and cigarettes. Application of the scrap classification to the principal output distorts the original and still valid understanding of scrap tobacco. Customs recognized this when, after studying the issue, it ruled in August 1976 that tobacco strips should not be classified as scrap. However, Customs reverted to the scrap classification in June 1977 on the basis that classifying tobacco strips as scrap had been a long-standing practice.

HOW TOBACCO STRIPS SHOULD BE CLASSIFIED

Tobacco strips most appropriately fall under the classification for stemmed cigar or cigarette filler tobacco. Strips are leaf tobacco, with the stem removed, intentionally broken into pieces.

The tariff schedules governing tobacco originated at a time when tobacco was hand

stemmed. Hand stemming yielded (1) the stemmed leaf (usually in two or more pieces of varying size) as the principal product and (2) scrap as a by-product of this hand stemming process. However, the advent of machine stemming processes has changed the practical application of the stemmed leaf and scrap concepts reflected in the tariff schedules. The mechanical processes in use today not only remove the stem from tobacco leaf but further process the leaf into tobacco strips so that they can ultimately be used in the making of cigars and cigarettes. These tobacco strips are the main product of the process. Scrap, in the original tariff sense, has been reduced to fragments 1/4 inch or less in size.

The closer to finished form tobacco is when imported, the higher the duties. Thus, stemmed filler leaf tobacco carries higher duties than whole leaf tobacco. Intentionally breaking tobacco leaf into pieces so as to place it in a more usable form should not as such effect the classification or reduce the duties to be paid. Customs' classification of this tobacco as "scrap" misapplies the traditional concept of scrap as a by-product, rather than the primary product, of the stemming process. It also denies reality by in effect holding that little filler leaf tobacco is now being imported. For example, in 1978 imported stemmed leaf tobacco totaled about 2.5 million pounds, while tobacco imported as scrap totaled about 119 million pounds. What used to be filler leaf is now just scrap.

Customs' classification approach over the years has remained essentially static, despite changes in industry practices. Customs contends that the stemmed tobacco leaf classification applies only to tobacco essentially in its original leaf form with

the stem removed--two half leaves. This, of course, was the principal output of the hand stemming process.

Through the years, Customs had ruled that tobacco leaf broken into pieces not under 4 inches was to be classified as stemmed tobacco leaf. Because tobacco strips average 1/2 by 2 inches, Customs believes the leaf tobacco classifications do not apply, and in its August 1976 ruling placed tobacco strips into a catchall classification for tobacco not specifically provided for in the tariff schedules.

This alternative--tobacco not specifically provided for--is not viable for much the same reasons that cause rejection of the present "scrap" classification. First, there is no basis to depart from the more specific classifications for stemmed filler tobacco. Second, the catchall item would, like the present "scrap" approach, deny reality and essentially classify filler tobacco out of existence as an import product.

An American manufacturer has petitioned Customs to change its scrap classification for threshed leaf tobacco. Notice of the petition was published in the Federal Register, and interested parties may comment on the petition before November 27, 1979.

CONCLUSION

Imported tobacco processed into strips under 4 inches in length is incorrectly classified by Customs as scrap. The strips more appropriately fall under the classification for stemmed cigar or cigarette filler leaf tobacco.

An American manufacturer petitioned Customs to change its scrap classification. A decision to continue the scrap classification would perpetuate, in GAO's opinion, a misclassification. On the other hand, a decision to change would alter a long-standing practice. Customs may be reluctant to do that.

Whatever the ultimate decision, it may not be made for quite some time, and the issue may end up in the courts. Because of these circumstances, legislation clearly setting forth congressional wishes on tobacco classification may be a quicker means of settling the matter. However, the fault lies with Customs' interpretation of the Tariff Schedules, rather than the schedules themselves.

The requesters' offices asked GAO not to obtain Customs' written comments on this report, but the technical aspects of our study were discussed with agency officials.

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CHAPTER 1

INTRODUCTION

Increases in the volume of imported tobacco classified as scrap prompted Senators Helms and Huddleston and Representative Walter B. Jones to ask us to review the U.S. Customs Service's classification of tobacco imports. (See app. I & II.) At issue is whether the scrap classification has been correctly applied.

For tariff purposes, filler tobacco is all leaf tobacco with or without the stem other than leaf that is of sufficient size and quality for use as cigar wrappers. (See app. III.) Cigar filler leaf is used chiefly in the body or core of cigars and in tobacco products other than cigarettes. There are several types of imported cigarette filler leaf--oriental, turkish, flue-cured, and burley--that are usually blended with domestic tobacco for the production of U.S. cigarettes.

STEMMING OF TOBACCO

The tobacco in question originates as a whole leaf including stem. During the stemming operation, the stem is removed and the leaf intentionally broken into pieces by a machine process known as threshing.

While machine stemming methods may vary, the basic procedure the tobacco industry uses today is as follows. Leaf tobacco is arranged on a blending line, the leaf is moisturized, the stem is removed and the leaf intentionally broken into pieces. The process results in pieces of leaf referred to as strips by the tobacco industry, averaging approximately 1/2 inch by 2 inches, with no pieces usually over 4 inches. The tobacco strips are usually blended with other types of tobacco for further processing in the making of tobacco products. During the stemming process, a number of by-products are acquired. They include:

--Stems.

--Scrap. Scrap is normally considered by industry as tobacco leaf fragments that are 1/4 inch or 1/8 inch or less.

--Waste. Waste is the sand and dust collected at various points in the operation.

See photographs on pages 4 and 5.

CLASSIFICATION OF IMPORTS

One of Customs' major responsibilities is the assessment and collection of tariff duties on imports. The assessment of duties involves classifying imports under the appropriate item number and provision of the Tariff Schedules of the United States.

The Tariff Schedules contain approximately 6,000 5-digit item numbers which constitute a legal class for a specifically named (eo nomine) or a generally described class of merchandise. In classifying items, officials consider such factors as the common and commercial meanings, use, and similarity to other merchandise specially provided for in the schedules.

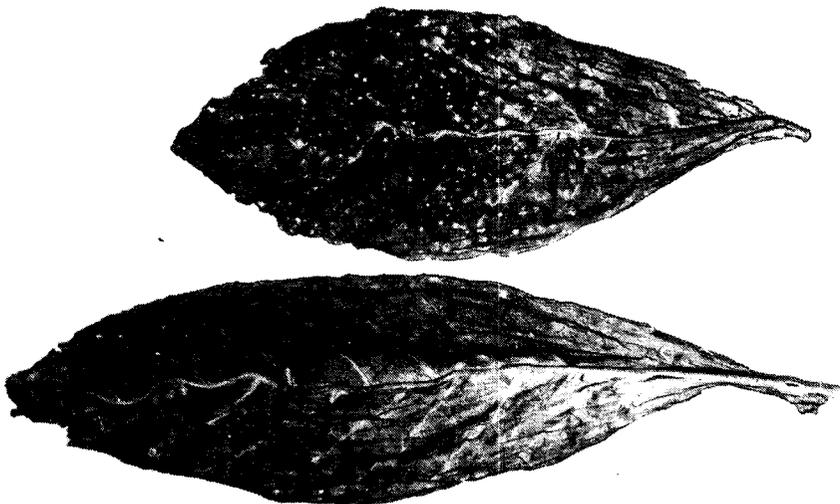
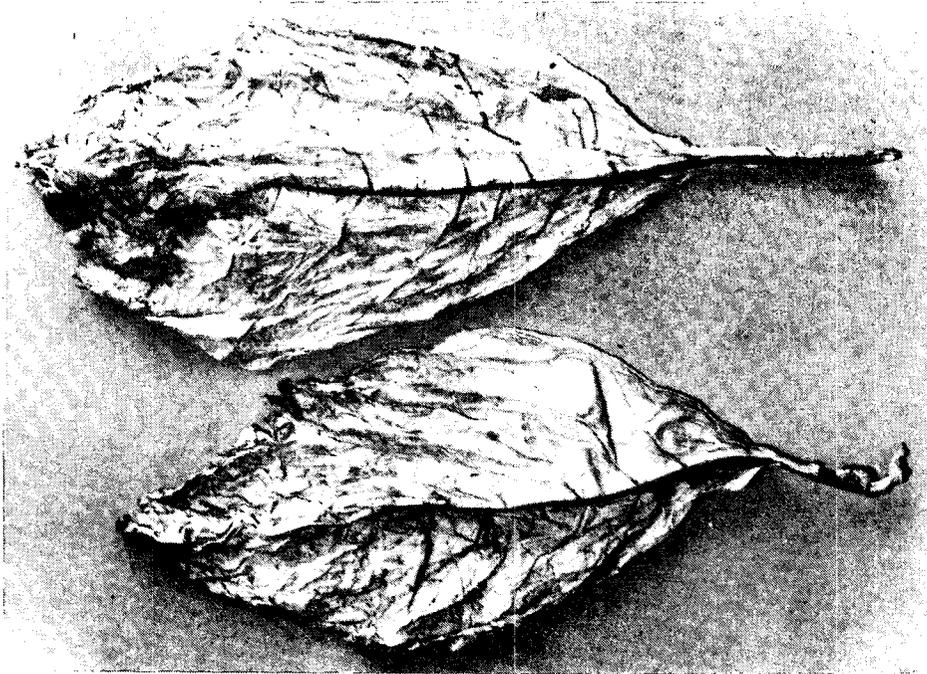
Provisions relating to the classification of tobacco and tobacco products are found in Tariff Schedule I, Part 13. These schedules include a list of headnotes to be used as guidelines for determining proper classification. (See app. III.)

CLASSIFICATION RULINGS

Anyone with a direct and demonstrable interest in a classification matter may request a classification ruling from the Customs Service's Office of Regulations and Rulings. A ruling is a written statement that interprets and applies the tariff provisions and related laws to a specific set of facts. A ruling is generally issued as a ruling letter to the requester and/or as a published ruling in the Customs Bulletin.

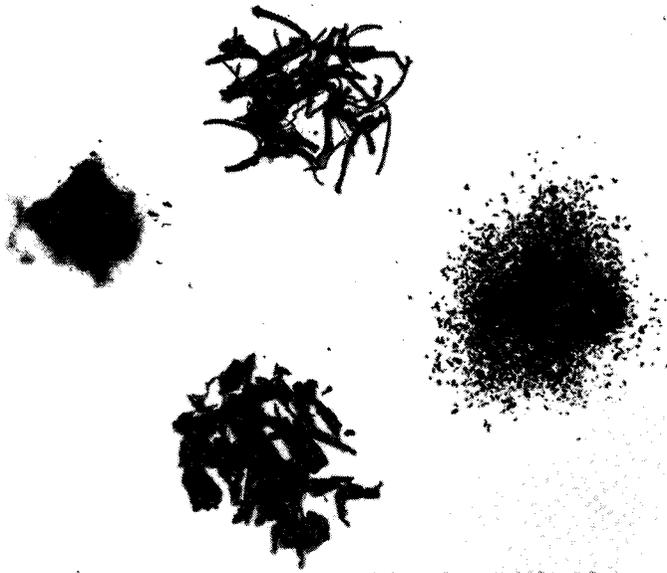
If an American manufacturer, producer, or wholesaler wishes to protest a classification he can do so by filing a petition with the Commissioner of Customs. If the Commissioner agrees with the petitioner that the classification is incorrect, action will be taken to change the classification.

A classification can also be changed by Customs. This involves publishing a notice of the intended change in the Federal Register and providing interested parties with an opportunity to present evidence either supporting or opposing the change.



FILLER LEAF TOBACCO NOT STEMMED

Source: GAO



PRODUCTS OF STEMMING PROCESS

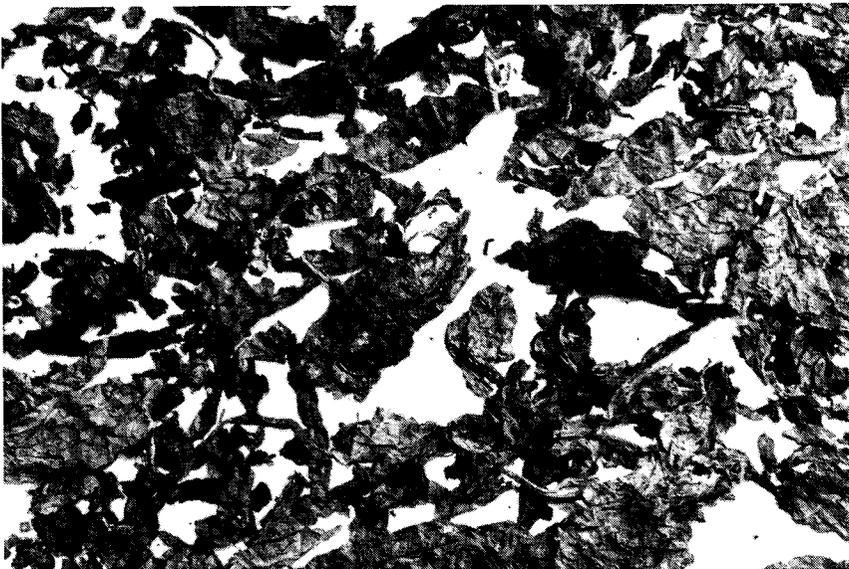
Source: GAO

STEMMED LEAF (bottom)

STEMS (top)

DUST (left)

SCRAP (right)



STEMMED TOBACCO LEAF

Source: GAO

CHAPTER 2

CUSTOMS' CLASSIFICATION OF TOBACCO

STRIPS AS SCRAP IS NOT CORRECT

Imported tobacco that has been processed into strips for use in the manufacture of cigars and cigarettes is incorrectly classified by Customs as scrap tobacco. The tobacco strips are the principal product produced in the threshing process and should be classified as stemmed cigar or cigarette filler leaf, dutiable at 23 cents and 45 cents per pound respectively, and not as scrap dutiable at 16 cents per pound. Because of the scrap classification, as much as \$188 million in import duties may have been lost in the last 10 years.

Customs contends that the stemmed tobacco leaf classification applies to only tobacco in essentially its original leaf form with the stem removed. Through the years, Customs had ruled that tobacco leaf is in "essentially leaf form" if broken into pieces not under 4 inches in length. There is, however, no judicial precedent designating a particular size as a determining factor in defining leaf form. Nor do the tariff schedules or their legislative history refer to size as a means of determining what constitutes stemmed cigar or cigarette leaf tobacco.

TOBACCO STRIPS ARE NOT SCRAP

Tobacco strips are various types of filler leaf tobacco, intentionally broken into pieces averaging 1/2 inch by 2 inches, with the stem, scrap fragments, and dirt removed. As such it does not fit the judicial, industry, or other definitions of scrap.

The genesis of the term scrap tobacco predates 1909, when the term first appeared in the Tariff Schedules of the United States. Before then, various judicial decisions were rendered on how scrap tobacco should be dutied, if at all, in the absence of a scrap classification in the Tariff Schedules. The definition of scrap was not an issue; the decisions agreed that scrap tobacco was small particles broken from the leaves in handling, manufacturing cigars, or removing the stem from leaves. To forestall further litigation on how scrap tobacco should be dutied, a special provision for scrap was put into the tariff schedule of 1909.

In addressing the classification of scrap tobacco under the Tariff Act of 1897, the Supreme Court (Latimer v. United States, 223 U.S. 501 (1911)), defined scrap tobacco as small pieces of tobacco that break from the brittle leaves and fall to the floor of the warehouse or factory in the process of manufacturing and handling. These scraps were swept up, and when cleaned, were used in the manufacture of a cheap grade of cigarettes and stogies.

In United States v. Schroeder (93 Fed. Rep. 448 (1899)), the following definition of scrap tobacco was not contested by either party to the action. This definition considers the breaking of leaves to make scrap tobacco to be unintentional.

"'Scrap tobacco'* * *[comes] to this country in bales of a peculiar size, differing from those of wrapper or filler tobacco. It is the part that falls when stripping the tobacco to prepare the leaf to go into the cigar. In the process of manufacturing cigars, they take tobacco in the leaf, put it first on racks to dry, then in barrels to sweat, and then put it on the cigar maker's table. In all this handling--racking, barreling, taking out and putting on the table,--there is always more or less breakage of the tobacco leaf; and the particles which fall in handling, and those which are broken from the leaf in the process of stemming, make this scrap tobacco. They drop to the floor, and are swept up. It [scrap tobacco] is worth about one-quarter the value of the tobacco leaf from which it comes. The breaking is not intentional. In the rough handling of the leaf in tearing off the stem, pieces fall to the floor, which the workman does not stop to pick up, but which are subsequently collected from the floor as scraps. It is principally used for cigarettes and the cheaper grades of cigars,--* * *and can only be used for filler." (Emphasis added.)

The legislative history of the tariff acts provides little definitive guidance in determining what scrap tobacco is. Scrap tobacco was apparently included in the Tariff Act of 1909 to resolve its status for duty purposes. Notes prepared for the House Committee on Ways and Means to revise the Tariff Act of 1897 stated that to forestall

further litigation it might be advisable to make special provision for scrap tobacco. But scrap tobacco was not defined.

The tariff provisions presently in force are known as the Tariff Schedules and are found in Title I of the Tariff Act of 1930, as amended. The legislative history of the Tariff Schedules of the United States, however, does not define scrap tobacco.

The court decisions remain consistent with the current understanding of the term scrap tobacco. For example, Webster's Third New International Dictionary and the Tobacco Dictionary (Philosophical Library, New York, 1954) define tobacco scrap as a by-product of the handling of tobacco consisting of loose tangled pieces of leaves, floor sweepings, and all other tobacco materials, except stems, which accumulate in the manufacturing process. The stemmed tobacco in question differs from the dictionary definition of scrap, because it is not a "by-product" but the principal product of stemming tobacco leaf.

Also, the tobacco industry applies the term scrap to small leaf fragments. These fragments are 1/4 inch or 1/8 inch or less and/or tobacco leaf that will pass through a 1/8 inch screen during the stemming process. The tobacco in question, however, averages 1/2 inch by 2 inches and is known as "strips" in the industry.

Several tobacco importers, leaf processors, and manufacturers discussed the stemming and classification of tobacco with us. Some of their comments follow:

- Leaf tobacco was stemmed by hand for many years. Stemming produced a whole leaf with most of the bottom stem removed or entire half leaves. Technology for stemming by machine came into use, and most tobacco is now machine threshed. Machine stemming--threshing process--includes (1) drying and sorting the leaves, (2) stemming the leaves, and (3) breaking the leaves into pieces under 4 inches. The main objective of the threshing process is to remove as much of the leaf from the stem as possible.
- The tobacco tariff schedule does not adequately define what is stemmed leaf and what is scrap tobacco. Also, it has not kept up with technology

for processing tobacco. Because Customs states that pieces of leaf tobacco under 4 inches in length is scrap for tariff purposes, the leaf in its processed form is properly classified.

--The industry views scrap as a product smaller than the primary product resulting from machine stemming.

TOBACCO STRIPS SHOULD BE
CLASSIFIED AS STEMMED LEAF

Tobacco strips most appropriately fall under the classification for stemmed cigar or cigarette filler leaf tobacco. Strips are leaf tobacco, with the stem removed, intentionally broken into pieces, primarily used in manufacturing cigars and cigarettes.

The tariff schedules governing tobacco originated at a time when tobacco was hand stemmed. Hand stemming yielded (1) the stemmed leaf (usually in two or more pieces of varying size) as the principal product and (2) scrap as a by-product of this hand stemming process. However, the advent of machine stemming processes has changed the practical application of the stemmed leaf and scrap concepts reflected in the tariff schedules. The mechanical processes in use today not only remove the stem from tobacco leaf but further process the leaf into tobacco strips so that they can ultimately be used in the making of cigars and cigarettes. These tobacco strips are the main product of the process. Scrap, in the original tariff sense, has been reduced to fragments 1/4 inch or less in size.

Customs' classification of tobacco strips as "scrap" misapplies the traditional concept of scrap as a by-product, rather than the primary product, of the stemming process. The closer to finished form the tobacco is when imported, the higher the duties. Thus, stemmed filler leaf tobacco carries higher duties than whole tobacco leaf. (See app. III.) Intentionally breaking tobacco leaf into pieces so as to place it in a more usable form should not as such effect the classification or reduce the duties to be paid.

The classification also denies reality by in effect holding that little filler leaf tobacco is now being imported. For example in 1978, imported stemmed leaf tobacco totaled about 2.5 million pounds, while tobacco imported as scrap totaled about 119 million pounds. What used to be filler leaf is now just scrap.

Customs contends that the stemmed filler tobacco classification applies only to tobacco in essentially its original leaf form with the stem removed. Through the years, Customs had ruled that tobacco leaf is in essentially leaf form if broken into pieces not under 4 inches. Thus, a tobacco product reduced from a leaf to a strip averaging about 1/2 by 2 inches is no longer a leaf.

The basis for Customs' rulings is unclear. There is no judicial ruling designating a particular size as a determining factor in defining leaf form. Nor do the tariff schedules or their legislative history refer to size as a means of determining what constitutes other stemmed cigar or cigarette leaf tobacco.

Customs support for the scrap classification is due in part to it being a long-standing practice. In early 1976 an importer asked Customs for a classification decision on imported tobacco which has been processed from leaf by machine to prepare it for use in the manufacture of cigarettes. According to the importer, the threshed tobacco was being classified differently at various ports. The importer suggested it be classified as scrap tobacco.

Customs, on August 31, 1976, ruled that stemmed tobacco leaf for use in the manufacture of cigarettes was classifiable as "tobacco manufactured or not manufactured, not specially provided for." This 1976 decision, however, was contrary to Customs' long-standing practice of classifying such tobacco as scrap. For that reason, Customs, on June 16, 1977, changed its August 1976 ruling and continued to classify such tobacco as scrap.

Classifying tobacco strips under the catchall for tobacco not specifically provided for is not viable for much the same reasons that cause rejection of the present "scrap" classification. First, there is no basis to depart from the more specific classifications for stemmed filler tobacco. An eo nomine or named classification such as stemmed filler tobacco takes priority over a more general description such as tobacco, not specifically provided for. That is, when Congress has provided for an article by a specific name, the specific classification must prevail over a provision where the article is included within the terms of a general description. Second, the catchall item would, like the present "scrap" approach, deny reality and essentially classify filler tobacco out of existence as an import product.

EFFECT OF CHANGE IN TOBACCO
STRIP CLASSIFICATION

What would have happened had Customs correctly classified imported tobacco strips as stemmed filler leaf tobacco instead of as scrap is difficult to gauge. One, the amount imported may not have changed; therefore, over the last 10 years, an additional \$188 million in duties may have been collected. Two, a higher duty rate may have resulted in a different composition of tobacco imported--less threshed tobacco and more whole leaf. Three, tobacco imports may have decreased, and the use of domestic tobacco may have increased.

The following schedules show imports of stemmed filler leaf tobacco and scrap as classified by Customs.

TOBACCO IMPORTS

<u>Year</u>	<u>Stemmed leaf tobacco</u>		
	<u>Cigarette</u>	<u>Other including cigar</u>	<u>Scrap</u>
	----- (000 lbs) -----		
			(note a)
1969	35	2,457	58,940
1970	2	2,627	62,146
1971	6	3,160	72,061
1972	7	2,507	61,069
1973	0.6	3,041	77,786
1974	0	3,364	95,835
1975	5	3,052	84,092
1976	0	2,416	84,028
1977	13	2,517	108,716
1978	35	2,498	119,072

a/ During 1977, there were imports of 76.9 and 31.8 million lbs. of stemmed cigarette and cigar leaf classified as scrap, respectively. In 1978, the quantities were 88.3 and 30.7 million lbs. Prior to 1977, trade statistics did not breakout the cigarette and cigar imports.

SCRAP TOBACCO IMPORTS
FROM MAJOR EXPORTING COUNTRIES

---(millions of lbs.)---

	Year									
	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Argentina	1.3	1.8	3.1	2.5	4.9	5.2	7.5	4.6	6.5	5.5
Brazil	3.7	3.8	4.1	6.0	10.5	9.8	11.4	14.6	25.3	24.6
Colombia	4.7	4.4	4.6	5.8	6.7	3.6	5.0	2.8	3.7	3.8
Dominican Republic	5.6	6.6	6.5	6.2	8.0	6.7	9.2	7.8	7.5	5.6
Indonesia	1.5	2.1	1.5	1.3	2.6	4.6	3.7	4.2	4.6	6.5
Korea	.2	-	1.3	-	4.5	2.9	7.3	12.1	16.4	16.7
Mexico	1.5	1.5	1.9	3.4	9.4	16.0	5.8	4.1	5.8	9.0
Philippines	23.7	19.3	26.2	17.0	13.6	22.1	13.5	15.6	13.3	14.8
Turkey	8.2	10.7	10.1	10.6	7.2	6.7	5.8	5.0	6.4	6.6
All other imports	<u>8.5</u>	<u>11.9</u>	<u>12.8</u>	<u>8.3</u>	<u>10.4</u>	<u>18.2</u>	<u>14.9</u>	<u>13.2</u>	<u>19.2</u>	<u>26.0</u>
Totals	<u>58.9</u>	<u>62.1</u>	<u>72.1</u>	<u>61.1</u>	<u>77.8</u>	<u>95.8</u>	<u>84.1</u>	<u>84.0</u>	<u>108.7</u>	<u>119.1</u>

Customs classified tobacco strips as scrap at 16 cents per pound rather than stemmed cigar or cigarette filler leaf at 23 and 45 cents per pound respectively. From 1969 to 1978, annual imports of stemmed leaf have remained about the same while scrap imports have doubled, going from 59 to 119 million pounds. If scrap tobacco had been dutied at the Tariff Schedule rates for either stemmed cigar or cigarette leaf, and the amount imported had not changed, Customs would have collected an additional \$188 million during the period.

Classifying tobacco strips as stemmed filler leaf, however, may have changed the composition of the tobacco imported. Importers pay duty on the weight of the product imported. Threshing the leaf prior to importation results in a significant weight loss in the amount of tobacco subjected to duty. For example, whole cigarette and cigar tobacco leaf normally contains between 25 and 28 percent stem weight. Stems, if imported separately, are duty-free.

Whole cigar leaf is dutied at 16.1 cents per pound, and stemmed cigar leaf is dutied at 23 cents per pound. Given the weight lost in the threshing process, there is little difference in total duties paid between importing whole cigar leaf or threshed cigar leaf. On the other hand, whole cigarette leaf is dutied at 12.75 cents per pound, and stemmed cigarette leaf is dutied at 45 cents per pound. With this large difference in duty rates, more whole leaf and less cigarette leaf strips may have been imported if the strips were properly classified as stemmed leaf.

Alternatively, eliminating the low duty rate for tobacco strips may have resulted in decreased imports. The difference between imported scrap at the rate of 16.1 cents per pound and that for an equivalent amount of tobacco in whole leaf form would be about 25 and 50 percent more for cigarette and cigar leaf, respectively. Similarly, the stemmed leaf rate exceeds the scrap rate by 180 percent for cigarette leaf and 45 percent for cigar leaf. These increases may create economic disadvantages so great as to discourage imports, thereby increasing the demand for domestic tobacco.

Other factors which would influence what might have happened are: price and availability of foreign versus

domestic tobacco, foreign versus domestic threshing costs, and transportation costs for threshed versus whole leaf tobacco.

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An American manufacturer has petitioned Customs to change its scrap classification for machine stemmed cigarette leaf filler tobacco strips under 4 inches in length. Notice of the petition was published in the Federal Register on September 28, 1979. Parties interested in commenting on this petition must make their views known to Customs by November 27, 1979.

CONCLUSION

Imported tobacco processed into strips under 4 inches in length for manufacturing cigars and cigarettes is incorrectly classified by Customs as scrap. The strips more appropriately fall under the classification for stemmed cigar or cigarette filler leaf tobacco.

An American manufacturer has petitioned Customs to change its scrap classification. A decision to continue to apply the scrap classification would perpetuate, in our opinion, a misclassification. On the other hand, a decision to change would alter a long-standing classification practice. Customs may be reluctant to do that.

Whatever the ultimate decision, it may not be made for quite some time, and the issue may end up in the courts. Because of these circumstances, legislation clearly setting forth congressional wishes on tobacco classification may be a quicker means of settling the matter. If legislation is deemed necessary, it should clearly provide that the by-products of handling tobacco be included in the scrap classification. However, the fault lies with Customs' interpretation of the Tariff Schedules, rather than the schedules themselves.

CHAPTER 3

SCOPE OF REVIEW

We performed our review at Customs headquarters in Washington, D.C., and Customs offices in New York; Norfolk and Richmond, Virginia; Wilmington, North Carolina; and Tampa, Florida. We interviewed Customs personnel and reviewed pertinent files and internal audit reports. We observed entries of tobacco at the ports and discussed Customs' classification policies and practices with import specialists. We also observed the processing of filler tobacco leaf in a class 8 Customs bonded warehouse.

We reviewed the Tariff Schedules of the United States, various court decisions, and the Customs' rulings relating to tobacco classification. We also discussed the tobacco classification practices with importers, dealers, and processors of leaf tobacco and representatives of cigar and cigarette manufacturers. As discussed with the requesters, we agreed to concentrate our efforts on the propriety of the scrap classification.

WALTER B. JONES
1ST DISTRICT, NORTH CAROLINA

TELEPHONE: CODE 202: 225-3101

FLOYD J. LUPTON
ADMINISTRATIVE ASSISTANT

COMMITTEES:
AGRICULTURE
MERCHANT MARINE
AND FISHERIES

Congress of the United States
House of Representatives
Washington, D.C. 20515

20 October 1978

Mr. Elmer B. Staats
Comptroller General
General Accounting Office
441 G Street
Washington, D. C. 20548

Dear Mr. Staats:

I have become highly concerned about the ever-increasing amounts of unmanufactured tobacco imports brought into the United States, particularly those types labeled as "scrap" for tariff purposes. I respectfully request that you study the whole issue of these imports with particular attention to action by the U. S. Customs Service in 1977 changing the definition of "scrap" tobacco for assessment of tariffs.

The duty for scrap tobacco is 16.1¢ per pound while de-stemmed machine tobacco is subject to a 45¢ per pound import tax. Thus there is a high incentive for those importing tobacco to have it classified as "scrap". Statistics compiled by the Foreign Agricultural Service of the U. S. Department of Agriculture indicate that there have been dramatic increases in the amount and value of "scrap" tobacco imported to this country. Furthermore, scrap imports have continued to increase when viewed as a percentage of total imports of unmanufactured tobacco. These shifts have occurred at about the same time that the Customs Service revised its definition of "scrap" tobacco to embrace a much larger variety of tobacco types than previously.

Many of us interested in tobacco are quite disturbed by these trends. "Scrap" imports jeopardize the share of our domestic markets now enjoyed by our own tobacco producers. The government also suffers as it loses significant revenues from lower import duties. Finally, the threat of government losses by the Commodity Credit Corporation increases, because of greater difficulty in disposing of domestic tobacco leaf taken by grower cooperatives under federal price support loans.

Mr. Elmer B. Staats
20 October 1978
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I believe that the decision to revise the definition of "scrap" tobacco should be thoroughly reviewed, especially as it relates to the greater problem of tobacco imports. I believe that other Members of Congress are in the process of advising you of similar concerns. I hope that you will advise us of the progress of such an investigation.

Many thanks for your kind attention to this matter, and with best wishes, I am

Sincerely,


Walter B. Jones
Member of Congress

WBJ:wbc

APPENDIX I

CHART I.—TOBACCO TARIFF AVOIDANCE

(Value in dollars)

Country	Unmanufactured tobacco (less scrap)						Scrap tobacco						Potential revenue, less per year 1977			
	1977			(More/less) change			1977			(More/less) change						
	Met-ric tons	Value	Total value	Met-ric tons	Value	Percent change, metric tons	Met-ric tons	Value	Total value	Met-ric tons	Value	Percent change, metric tons				
CATEGORY I																
Korea	2,208	1,538,000	3,567,000	3,761	+1,729,000	-20.24	303	381,000	25,592,000	1,2482	+9,997	+2,969,000	84.0			
Thailand	1,522	1,174,000	2,578,000	1,744	+1,172	-329.89	121	64,000	3,712,000	7820	+2,032	+3,646,000	1,679.34			
Brazil	6,528	5,072,000	17,889,000	5,264	+12,787,000	+95.97	839	784,000	10,736,000	8256	+5,031	+9,968,000	1,585.68			
Total	9,328	7,205,000	25,902,000	10,937	+18,687,000	+81.55	1,283	1,215,000	40,040,000	1,0472	+16,060	+38,825,000	+1,251.75			
70-74 avg													10,267,796.90			
CATEGORY II																
Costa Rica	108	209,000	5072	1	-207,000	-99.07	29	4,000	1,850,000	1,2714	+631	+1,846,000	+2,175.86			
Guatemala	128	157,000	5199	158	+423,000	+123.44	119	180,000	1,166	3,294,000	1,2814	+1,047	+1,114,000			
Indonesia	1,741	1,401,000	1,397	1,201,000	-390	-344	656	226,000	1,899	1,480,000	-3555	+1,243	+1,254,000			
Panama	0	1,000	0	0	-200,000	-19.76	0	1,000	292	921,000	1,4307	+292	+920,000			
Total	1,977	1,768,000	1,784,000	1,865	+16,000	-14.82	804	411,000	4,017	7,545,000	8520	+3,213	+7,134,000			
CATEGORY III													2,054,198.60			
All other countries	92,419	127,495,000	82,918	228,715,000	1,251	-9,501	+101,220,000	-10.28	20,618	17,260,000	16,149	14,985,000	4,209	-4,469	-2,275,000	-21.68

Category IV: All countries total	Unmanufactured leaf including scrap			Just scrap			Unmanufactured leaf less scrap		
	Avg 68-73	Avg 70-74	1977	Avg 68-73	Avg 70-74	1977	Avg 68-73	Avg 70-74	1977
Difference	119,380	130,179	139,332	20,264	24,280	37,509	99,116	105,889	101,843
			+9173		+13,229			-4056	

1977 scrap percent of total trade.

CHART II—"SCRAP" AS A PERCENTAGE OF TOTAL IMPORTS

Worldwide	1968-73 average			1970-74 average			1975			1976			1977			Net (+ or -)
	1968-73 average	1970-74 average	1975													
Worldwide	16.9	18.9	21.6	21.6	21.6	20.9	21.6	21.6	21.6	21.6	21.6	21.6	21.6	21.6	21.6	+
Canada	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8	+
Dominican Republic	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	14.6	+
Honduras	37.9	37.9	37.9	37.9	37.9	37.9	37.9	37.9	37.9	37.9	37.9	37.9	37.9	37.9	37.9	+
Mexico	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	+
Nicaragua	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	+
Argentina	23.5	23.5	23.5	23.5	23.5	23.5	23.5	23.5	23.5	23.5	23.5	23.5	23.5	23.5	23.5	+
Colombia	48.2	48.2	48.2	48.2	48.2	48.2	48.2	48.2	48.2	48.2	48.2	48.2	48.2	48.2	48.2	+
Paraguay	11.6	11.6	11.6	11.6	11.6	11.6	11.6	11.6	11.6	11.6	11.6	11.6	11.6	11.6	11.6	+
Italy	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	+
Philippines																+
Turkey																+
Category I:																+
Iceland																+
Ireland																+
Brazil																+
Category II:																+
Costa Rica																+
Guatemala																+
Indonesia																+
Panama																+

JESSE HELMS
NORTH CAROLINA

United States Senate

WASHINGTON, D.C. 20510

October 13, 1978

Mr. Elmer B. Staats
Comptroller General of the United States
General Accounting Office
441 G Street, N. W.
Washington, D. C. 20548

Dear Mr. Staats:

We wish to bring to your attention what we understand to be importation of considerable quantities of unmanufactured tobacco into the United States, which appears to avoid the lawful tariffs on such products.

This information is particularly disturbing to me because of the adverse impact it has upon domestic tobacco producers, and because the circumstances surrounding recent changes in policy which permit this activity seem to raise serious questions, in that they may have been perpetrated in an effort to legitimize some such actions after the fact.

The adverse impact upon the domestic producers is caused by the fact that avoidance of proper and appropriate tobacco tariffs has encouraged an increase in the importation of foreign unmanufactured tobacco into the United States, particularly in the type of tobacco known as "scrap." These increased imports come at a time when the market share of domestic tobacco growers has been declining, both in the United States market and in the world trade. Further, the application of improper tariffs has had the effect of encouraging the foreign production of tobacco for the world trade, thereby creating domestic and worldwide competition for U. S. producers that would not have otherwise existed. Finally, the increase in the incidence of importation of such foreign tobaccos has come at a time when the surplus of tobacco, held by the Flue-Cured Tobacco Cooperative Stabilization Corporation, has reached record levels, currently totalling some 540 million pounds. The incidence of increased imports threatens to weaken the economic stability of the Tobacco Program, thereby threatening the livelihood of some 500,000 farm families in America.

The interests of the United States may have been further impacted adversely by a revenue loss from uncollected tobacco

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tariffs which may, in total, exceed \$100 million. Additionally, the increased tobacco imports have come at a time when the U. S. balance of trade has not been favorable, thereby weakening and undermining the value and strength of the dollar.

By letter of June 16, 1977, the U. S. Customs Service reversed its standing definition of "scrap" tobacco by permitting that designation "to include leaf tobacco which has been broken or threshed into pieces principally under 4 inches in length," according to an undated Customs Service memorandum entitled "Tobacco." "Consequently," the memorandum continues, "the provision for scrap tobacco now embraces tobacco which has been manufactured specifically for cigarette making needs." Scrap tobacco is dutiable at the rate of 16.1¢ per pound, whereas de-stemmed machined tobacco pays a 45¢ per pound import tax.

In our view, the June 16, 1977 definition of "scrap" tobacco is improper and deceptive, and should be reversed immediately. Besides being a completely inaccurate description of scrap tobacco, it amounts to a virtual unilateral reduction in the tobacco tariff by the United States, and as such, is reckless and irresponsible.

Because the ruling followed what appears to be several years of increasing incidence of declaration of the unmanufactured tobacco in question as scrap, the possibility exists that the June 16 definition may have been sought to legitimize previous declarations that avoided the intent and purpose of the tariff laws. We believe all circumstances surrounding that decision should be thoroughly investigated so as to make clear to the public just exactly who requested the changes and for what reasons, and request that you conduct such an investigation.

Further, we are requesting the General Accounting Office to conduct a thorough study and investigation into the nature of the business and trade in "scrap" tobacco between the United States and those countries from which it is imported to determine just what, when, and why changes in practice regarding the leaf in question did take place.

However, we emphasize that it is most imperative and urgent that immediate actions be taken to properly define "scrap tobacco," and to collect full duties upon it. The tax on imported de-stemmed, unmanufactured tobacco used for cigarette making needs ought to be returned to the original 45¢ per pound rate as was originally intended when the rate was first adopted.

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A thorough analysis of tobacco imports from all countries indicates that the incidence of apparent tariff avoidance in appreciable volume is limited to less than ten countries. Chart I lists those countries, broken down into two categories. The Category I countries are Korea, Thailand, and Brazil. They are listed separately because the base year data is for the average of the five years 1969-1973, and because the volumes of tobacco, and in particular the increases in the importation of "scrap," are considerable.

The Category II countries of Costa Rica, Guatemala, Indonesia, and Panama are listed separately because the base year data is for the average of the five years 1970-1974, and because the volumes are not as great as those in Category I.

Category III provides comparison for all countries other than those in Categories I and II.

Category IV lists total volumes for all countries from which the United States imported tobacco during the years indicated.

Chart 2 lists countries from which sizable volumes of unmanufactured tobacco are imported. The figures in each column represent the percentage of "scrap" as a total of the entire trade. As can be seen from the figures, the amounts in trade designated as "scrap" have gradually increased from 16.9% in Avg 69-73 to 26.9% in 1977.

The data to substantiate these concerns and charges is found in The Foreign Agricultural Circular: Tobacco, Foreign Agricultural Service, U. S. Department of Agriculture, Washington, D. C. of March 1977 and February 1978, and is found collected in the charts attached to this letter.

So that the significance of the information contained in the attached charts may be better understood, please permit us to make the following commentary and points:

1. The first fact of which to take note is in Chart I, Category IV. The total imports of unmanufactured tobacco, not including scrap, for all countries, decreased by more than 4,000 metric tons, while imports of "scrap" tobacco increased dramatically by more than 13,000 metric tons.

2. In Category III, we find that the trend is slightly different, only more revealing for our purposes. The startling

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fact is that the combined total of imports for both unmanufactured leaf (less scrap) and for scrap itself declined by 9,500 metric tons or some -10% and by 4,500 metric tons or -22%, respectively.

3. In Categories I and II, we find virtually all of the increase in tobacco imports, and find that while in the case of Category I, there have been increases in both types of tobacco imports, the overwhelming increase in the volume of imports has been in scrap tobacco, and that it has come from these few countries.

4. The problem is most acute in the instance of Korea. Imports from Korea in the base years were predominately non-scrap. Yet, in 1977, the volume of non-scrap tobacco actually declined some 20%, while the volume of so-called "scrap" increased from 303 metric tons in Avg 69-73 to a whopping 9,300 metric tons in 1977 -- almost a 3,000% increase. What's more, the Koreans are so bold as to actually value the scrap at \$1.2482 per pound, while the other unmanufactured tobacco is listed at only \$.9188 per pound. And, the "scrap" accounted for 84% of the total trade in 1977 as compared to 12% in Avg 69-73.

5. The evidence seems overwhelming that Korea, sometime after 1969, but before 1977, began to increase its imports of unmanufactured leaf into the U. S. and began to call it "scrap," paying the lower duty of 16.1¢ per pound, rather than the 45¢ duty on de-stemmed unmanufactured leaf. Scrap accounted for 89% of the total trade in 1976; 49% in 1975; 41% in Avg 70-74; and, as previously stated, 12% in Avg 69-73.

6. If one calculates that the total avoidance can be attributed to the entire increase from Avg 69-73 through 1977, it appears as if Korea avoided some \$6 million in tariffs in 1977 alone (at \$.29 x 2204.62 lbs. x 8997 metric tons).

7. A review of Thailand reveals the same trends except that the value per pound of "scrap" appears to be more realistic when compared to other unmanufactured leaf imports. The increases in the incidence of "scrap" imports is 1,679% and the total "scrap" trade constitutes 48% of the total trade in 1966 as compared with 78% in 1976; 77% in 1975; 26% in Avg 70-74; and 18.8% in Avg 69-73.

8. Brazil is another culprit in all categories. Total "scrap" trade in 1977 was 31% of the total as compared to 23% in 1976; 8% in 1975; 11% in Avg 70-74; and 16.5% in Avg 69-73.

9. In countries in Category II, Costa Rica gets the prize

for the most probable case of possible avoidance of the tariffs. Total "scrap" trade is up almost 2,200% in volume and constitutes 99.8% of the total trade in 1977. Comparable figures for other years are: 86% in 1976; .6% in 1975; 21% in Avg 70-74.

10. Guatemala follows the very same trend with an increase in "scrap" trade of 880% in volume constituting 80.3% of the total trade in 1977. Comparable figures for other years are: 73.5% in 1976; 48.5% in 1975; 48% in Avg 70-74.

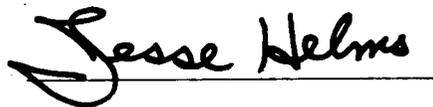
11. Panama's U. S. trade in tobacco is entirely in "scrap" and is an entirely new development, probably in direct consequence to the June 1977 re-definition of scrap tobacco.

12. Indonesia is another country that registered a significant decline in trade of unmanufactured leaf (less scrap) -- some -20%. And yet totalled an increase in "scrap" of 189%, with "scrap" constituting 57.6% of the trade in 1977; 81% in 1976; 61.9% in 1975; 39.2% in Avg 70-74.

With the presentation of this statistical evidence, we request that you thoroughly investigate the situation we have described, and as is most readily seen from the accompanying charts. We urge you to determine just what were the exact circumstances by which the changes in the Customs Service definition of scrap tobacco were undertaken, and for what reasons. I believe it is appropriate to determine at just whose request the change was made, and who was consulted in making the change. As stated earlier, it seems an entirely inappropriate and erroneous change.

We request you undertake this investigation with most deliberate speed, and hope you will keep me fully informed of all developments. We appreciate your interest and consideration.

Sincerely,



JESSE HELMS



WALTER D. HUDDLESTON

PART 13 HEADNOTES AND APPLICABLE
TARIFF SCHEDULES OF THE UNITED STATES
Schedule 1. - Animal and Vegetable Products
Part 13--Tobacco and Tobacco Products

Part 13 headnotes:

1. The term "wrapper tobacco", as used in this part, means that quality of leaf tobacco which has the requisite color, texture, and burn, and is of sufficient size for cigar wrappers, and the term "filler tobacco" means all other leaf tobacco.

2. The percentage of wrapper tobacco in a bale, box, package, or other shipping unit is the ratio of the number of leaves of wrapper tobacco in such unit to the total number of leaves therein. In determining such percentage for classification purposes, the appraiser shall examine at least ten hands, and shall count the leaves in at least two hands, from each shipping unit designated for examination.

* * * * *

<u>Item number</u>	<u>Article</u>	<u>Rate of duty</u>	
		<u>Column 1</u>	<u>Column 2</u>
	Filler tobacco (whether or not mixed or packed with wrapper tobacco):		
	When mixed or packed with over 35% of wrapper tobacco:		
170.20	Not stemmed.....	90.9 ¢ per lb.	\$2.275 per lb.
170.25	Stemmed.....	\$1.548¢ per lb.	\$2.925 per lb.
	When not mixed and not packed with wrapper tobacco, or when mixed or packed with 35% or less of wrapper tobacco:		
	Cigarette leaf:		
	Not stemmed:		

Item number

Filler tobacco (whether or not mixed, etc.) (con.):

When not mixed and not packed, etc. (con.):

170.28	Leaf, oriental or Turkish type, not over 8.5 inches in length.....	11.5¢ per lb.	35¢ per lb.
170.32	Other.....	12.75¢ per lb.	35¢ per lb.
10	Flue-cured		
30	Burley		
40	Other		
170.35	Stemmed.....	45¢ per lb.	50¢ per lb.
	Other, including cigar leaf:		
170.40	Not stemmed.....	16.1¢ per lb.	35¢ per lb.
170.45	Stemmed.....	23¢ per lb.	50¢ per lb.
170.60	Scrap tobacco.....	16.1¢ per lb.	35¢ per lb.
30	Cigar leaf		
40	Other		
170.80	Tobacco, manufactured or not manufactured, not specially provided for.....	17.5¢ per lb.	55¢ per lb.
20	Smoking tobacco in retail size packages		
40	Other		

NOTE: Column 1 rates are applicable to "more favored" countries while column 2 rates are applicable to communist countries with some exceptions.

(263750)