



EXECUTIVE SUMMARY

Department of Revenue and Taxation Bonded Warehouses for Tobacco Products OPA Report No. 19-07, November 2019

Since the tobacco bonded warehouse's enactment 60 years ago, the Department of Revenue and Taxation (DRT) still has not submitted any rules, regulations, and formally adopted policies that establish the official requirements for granting certification to and monitoring bonded warehouses for tobacco products. While DRT attempted to improve its bonded warehouse oversight, its current practices are not enough to provide reasonable assurance that all tobacco taxes are complete and properly accounted for. Furthermore, the Government of Guam (GovGuam) is not guaranteed to recover the full amount of any tobacco tax defaults because DRT does not have an official mechanism to define the standard amount of a surety bond.

After Office of Public Accountability Report No. 18-04, *DRT Tobacco Tax*, DRT has since implemented control procedures to help account for tobacco product quantities. Although DRT personnel spends significant hours in monitoring the movement of tobacco in and out of the bonded warehouse, and in conducting inventory count, DRT does not have personnel trained to properly monitor the bonded warehouses' accountability. We see loopholes where a wholesaler might underreport taxes.

The untimely reconciliation of tobacco withdrawn against the GRT-3 filing, coupled with unreliable inventory count, makes other control procedures useless. In addition, with the exclusion of tobacco products meant for drawbacks, there are opportunities for tax evasion because DRT does not verify whether the tobacco was actually exported or sold to the U.S. Military or Guam Airport concessionaires.

Although not directly related to our audit objective, we became aware of other issues related to certain wholesalers. We believe DRT incorrectly concluded that free tobacco samples were not subject to tobacco tax and might have inappropriately allowed Wholesaler O to discount tobacco products. As such, we recommend the DRT Director re-evaluate its conclusion on the taxation of free tobacco products and seek the Attorney General of Guam's opinion concerning the Master Settlement Agreement's authority and impact over Guam's taxation of tobacco products. Additionally, we recommend the DRT Director evaluate the circumstances in which tobacco wholesalers are selling tobacco at a discount.

Meanwhile, DRT did not examine 36 months of Wholesaler Z's incorrect tax filings and did not verify that the amended liability was in fact *all* that was owed by Wholesaler Z or any other wholesaler. As such, we recommend the DRT Director verify if Wholesaler Z's amended tax liability was accurate and complete. Additionally, we recommend the DRT Director create and implement a policy that all unusual and/or substantial amendments to tax liabilities be examined and verified for accuracy and completeness.

The law does not require a bonded warehouse from tobacco wholesalers. Deferring tobacco tax payments by having a bonded warehouse is a privilege, *not a right*, afforded by Guam law for the wholesaler's benefit. DRT's oversight of the bonded warehouses requires additional control procedures needed to account for all tobacco movement despite no identifiable benefit to GovGuam. Considering the control procedures needed to monitor the bonded warehouses, we recommend the Legislative Committee Chairperson on Revenue and Taxation repeal the bonded warehouse provision for tobacco tax. Once repealed, DRT must collect tobacco taxes immediately upon import from all tobacco wholesalers. As provided in the Tobacco Tax law, DRT will consider any export or consignment a drawback, where the burden of proof is on the taxpayer to provide.

Overall, we observed that DRT does not verify accuracy and completeness of tobacco tax filings. In this audit, the lack of verification stood out in several instances. DRT did not verify: (1) changes made by the wholesalers on the inventory count sheet, (2) actual deliveries of tobacco products outside of Guam, (3) actual sale of tobacco products to any U.S. Military or Guam Airport concessionaires, and (4) amended tax filings by Wholesaler Z. DRT could easily check the accuracy and completeness, or at least the reasonableness, of tobacco tax filings because it has direct monitoring responsibilities over the tobacco stored in the bonded warehouse. Still, it relied on the voluntary compliance of the wholesalers. Guam may be collecting \$23.5 million in tobacco tax revenue per year, but is this all?

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