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TAX ADMINISTRATION

IRS Excise Tax Audits of Manufacturers and Importers of Sporting Goods



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General Government Division

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January 5, 1987

The Honorable John B. Breaux
Chairman, Subcommittee on Fisheries
and Wildlife Conservation and the Environment
Committee on Merchant Marine and Fisheries

The Honorable Don Young
Ranking Minority Member, Subcommittee on
Fisheries and Wildlife Conservation and
the Environment
Committee on Merchant Marine and Fisheries
House of Representatives

By letter dated November 1, 1985, and in meetings with your representatives, you asked us to study the Internal Revenue Service's (IRS) compliance activities and the Treasury and the Interior Departments' accounting procedures for federal excise taxes imposed by Internal Revenue Code sections 4161(b) and 4181. These taxes apply to manufacturers, producers,¹ and importers of four categories of sporting goods--pistols and revolvers, other firearms, shells and cartridges, and bows and arrows. On April 10, 1986, we briefed the Subcommittee staff on our review and subsequently provided you with a briefing document.²

The briefing and the briefing document did not address all of the issues you asked us to study. For instance, we were unable to develop statistics comparing IRS' audit coverage of manufacturers with that for importers of sporting goods in time for the April 10, 1986, briefing. As discussed with the Subcommittee staff, we needed to perform additional work to supplement information contained in IRS' two relevant computerized data bases. Neither of the data bases--the Business Master File (BMF), which identifies the filers of excise tax returns, nor the Audit Information Management System (AIMS), which provides the results of examinations--differentiates between domestic manufacturers and importers. Your offices requested that we continue our work to develop comparative audit coverage statistics and this document presents the results of that effort.

¹We considered the terms "manufacturers" and "producers" as synonymous. Thus, for simplicity, we refer only to manufacturers throughout this document.

²Tax Administration: Excise Taxes on Sporting Arms, Ammunition, and Archery Equipment (GAO/GGD-86-114FS, Aug. 12, 1986).

Our detailed results for the 3-year period covering fiscal years 1983 through 1985 are presented in the tables in appendix I. The tables show that:

- IRS' audit coverage of sporting goods manufacturers averaged 2.88 percent annually, ranging from 2.02 percent in fiscal year 1985 to 3.60 percent in fiscal year 1983. The audit coverage of sporting goods importers averaged 7.34 percent, ranging from 4.52 percent in fiscal year 1985 to 9.60 percent in fiscal year 1983. (See table I.1.)
- On average, examinations of importers resulted in slightly higher proposed additional tax and penalties than examinations of manufacturers. (See table I.2.)
- On average, the no change percentages (the proportion of examinations that did not result in an IRS proposed change to the taxpayers' reported excise tax liabilities) for IRS examinations of manufacturers and importers averaged 21.92 percent and 26.01 percent, respectively. (See table I.3.)

We developed our comparative statistics by using a combination of computer-assisted and manual techniques. To identify sporting goods excise tax return³ filers, we obtained from IRS' National Computer Center a computer tape extract of the BMF which listed all Form 720 (Quarterly Federal Excise Tax Return) filers that reported a tax liability (for any taxable quarter ending March 31, 1981, through December 31, 1985) for one or more of the four applicable sporting goods categories. We then manually matched the BMF listing with various federal and private sector data sources to identify which filers were manufacturers, importers, or both. Next, we added these three identifiers to the BMF computer tape and provided it to IRS' Detroit Data Center. The Data Center computer-matched this tape with AIMS files for IRS

³We use the term "sporting goods excise tax return" to mean any IRS Form 720 (Quarterly Federal Excise Tax Return) that shows a tax liability for one or more of the four categories of sporting goods--pistols and revolvers, other firearms, shells and cartridges, and bows and arrows.

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examinations completed in fiscal years 1983, 1984, and 1985 to produce the various statistics comparing manufacturers with importers.

Two important limitations should be kept in mind when interpreting these statistics.

- We did not test the reliability of the data by tracing the computerized BMF extract data back to tax returns and the computerized AIMS data back to IRS revenue agent examination reports. This was because the returns and reports are geographically dispersed among various IRS service centers and district offices and federal records centers.
- We were unable to identify the category (manufacturer or importer) for over one-half of the names on the BMF extract (see app. II); thus, the resulting comparative statistics may not be representative of the universe of sporting goods excise tax return filers.

We conducted our review from November 1985 to August 1986. Except as noted above, our work was conducted in accordance with generally accepted government auditing standards. Appendix II presents further details about the objective, scope, and methodology of our work.

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As arranged with your offices, unless you publicly announce its contents earlier, we will make copies of this document available to IRS and other interested parties 10 days after you receive it.

If you have questions about this document, please contact Larry Endy of my staff on 376-0023.



Johnny C. Finch
Senior Associate Director

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ABBREVIATIONS

AIMS	Audit Information Management System
BMF	Business Master File
GAO	General Accounting Office
IRS	Internal Revenue Service

COMPARATIVE STATISTICS ON IRS' EXAMINATIONSTable I.1: IRS Audit Coverage of U.S. Manufacturers and Importers of Sporting Goods--Fiscal Years 1983-1985^a

Fiscal year	U.S. manufacturers ^b		U.S. importers ^b	
	Number examined	Percentage examined	Number examined	Percentage examined
1983	25	3.60	17	9.60
1984	21	3.03	14	7.91
1985	14	2.02	8	4.52
Average ^c	20	2.88	13	7.34

^aThese statistics may not be representative of the universe of sporting goods excise tax return filers because we were unable to identify the category (manufacturer or importer) for over one-half of the names on the BMF extract. See discussion of methodology in appendix II.

^bThe numbers of U.S. manufacturers and U.S. importers presented are the numbers of taxpayers examined, not the numbers of sporting goods excise tax returns examined. An IRS examination of a taxpayer may involve several quarterly returns. As shown in table II.1 in appendix II, we identified 635 entities/individuals that were manufacturers, 118 that were importers, and 59 that were both manufacturers and importers. In calculating comparative audit coverage percentages, we included the 59 entities/individuals in both columns. For example, the fiscal year 1983 audit coverage percentages for manufacturers and importers, respectively, were calculated as follows:

$$\frac{25}{(635 + 59)} = 3.60 \text{ percent} \qquad \frac{17}{(118 + 59)} = 9.60 \text{ percent}$$

Similarly, the percentages for 1984 and 1985 are based on 694 manufacturers (635+59) and 177 importers (118+59).

^cEach of the two average percentage examined figures is based on the actual average for the 3-year period. For example, the average percentage of U.S. manufacturers examined was calculated as follows:

$$\frac{(25 + 21 + 14)}{(694 \times 3)} = 2.88 \text{ percent}$$

Source: Computerized match, programmed at GAO's request by IRS' Detroit Data Center, of (1) a BMF extract of sporting goods excise tax return filers for taxable quarters ending March 31, 1981, through December 31, 1985, and (2) AIMS files for examination cases completed in fiscal years 1983-1985.

Table I.2: Comparative Results (Additional Tax and Penalties)
of IRS Excise Tax Examinations of U.S. Manufacturers and
Importers of Sporting Goods—Fiscal Years 1983-1985^a

Fiscal year	Additional tax and penalties proposed by IRS revenue agents ^b							
	U.S. manufacturers				U.S. importers			
	Total	Per taxpayer	Per return	Per examination hour	Total	Per taxpayer	Per return	Per examination hour
1983	\$ 274,897	\$ 10,996	\$ 2,182	\$ 381	\$ 499,355	\$ 29,374	\$ 4,624	\$ 926
1984	2,406,798	114,609	19,891	3,630	2,399,599	171,400	24,238	5,372
1985	10,768	769	125	21	45,689	5,711	692	123
Average ^c	\$ 897,488	\$ 44,874	\$ 8,085	\$1,415	\$ 981,548	\$ 75,504	\$10,786	\$2,172

^aThese statistics may not be representative of the universe of sporting goods excise tax return filers because we were unable to identify the category (manufacturer or importer) for over one-half of the names on the BMF extract. See discussion of methodology in appendix II.

^bThe Form 720 quarterly excise tax return has a separate line item for each category of excise tax, including the four sporting goods categories (see app. III). Thus, a single Form 720 return can report excise tax liabilities for more than one sporting goods category, and an IRS audit may concurrently cover more than one line item (excise tax category) shown on the return. In these instances, the AIMS data base records audit results—additional tax and penalties proposed, number of examination hours used, etc.—for each line item examined. In this regard, the per return and the per examination hour data presented in this table relates to examinations of Form 720 line items. However, the per taxpayer data in this table is based on the number of taxpayers rather than line items examined.

^cThe per taxpayer, per return, and per hour averages are based on the actual averages for the 3-year period rather than the average of the three annual averages. For example, the per taxpayer average for U.S. manufacturers was calculated as follows:

$$\frac{(\$274,897 + \$2,406,798 + \$10,768)}{(25 + 21 + 14)} = \$44,874$$

Source: Computerized match, programmed at GAO's request by IRS' Detroit Data Center, of (1) a BMF extract of sporting goods excise tax return filers for taxable quarters ending March 31, 1981, through December 31, 1985, and (2) AIMS files for examination cases completed in fiscal years 1983-1985.

Table I.3: Comparative Results (No Change Percentages) of IRS Excise Tax Examinations of U.S. Manufacturers and Importers of Sporting Goods—Fiscal Years 1983-1985^a

Fiscal year	Examinations of U.S. manufacturers ^b			Examinations of U.S. importers ^b		
	Number of returns examined	Number of no change returns	Percentage of no change returns	Number of returns examined	Number of no change returns	Percentage of no change returns
1983	126	31	24.60	108	41	37.96
1984	121	19	15.70	99	10	10.10
1985	86	23	26.74	66	20	30.30
Average ^c	111	24	21.92	91	24	26.01

^aThese statistics may not be representative of the universe of sporting goods excise tax return filers because we were unable to identify the category (manufacturer or importer) for over one-half of the names on the BMF extract. See discussion of methodology in appendix II.

^bThe Form 720 quarterly excise tax return has a separate line item for each category of excise tax, including the four sporting goods categories (see app. III). Thus, a single Form 720 return can report excise tax liabilities for more than one sporting goods category, and an IRS audit may concurrently cover more than one line item (excise tax category) shown on the return. In these instances, the AIMS data base records audit results—additional tax and penalties proposed, number of examination hours used, etc.—for each line item examined. In this regard, the data in this table relates to examinations of Form 720 line items rather than returns.

^cEach of the two averages for percentage of no change returns represents the actual average for the 3-year period rather than the average of the three annual averages. For example, the average percentage of no change returns for U.S. manufacturers was calculated as follows:

$$\frac{(31 + 19 + 23)}{(126 + 121 + 86)} = 21.92 \text{ percent}$$

Source: Computerized match, programmed at GAO's request by IRS' Detroit Data Center, of (1) a BMF extract of sporting goods excise tax return filers for taxable quarters ending March 31, 1981 through December 31, 1985, and (2) AIMS files for examination cases completed in fiscal years 1983-1985.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to develop comparative statistics on IRS excise tax examinations of manufacturers and importers of sporting goods. We used a combination of computer-assisted and manual techniques to develop these statistics. Because IRS' two relevant computerized data bases (BMF and AIMS) do not distinguish between manufacturers and importers, we used manual procedures to add manufacturer and importer identifiers to a BMF extract of filers of sporting goods excise tax returns. After we added the manufacturer and importer identifiers, IRS' Detroit Data Center matched information from the BMF extract with AIMS files to generate comparative audit coverage statistics.

IDENTIFYING SPORTING GOODS EXCISE TAX RETURN FILERS

To identify sporting goods excise tax return filers, we obtained from IRS' National Computer Center a computer tape extract of the BMF listing all Form 720 (Quarterly Federal Excise Tax Return) filers that reported a tax liability (for at least one quarter) for one or more of the four sporting goods line items on the form:

<u>Form 720 line item</u>	<u>Type of sporting good</u>
32	Pistols and revolvers
44	Bows and arrows
46	Other firearms
49	Shells and cartridges

The BMF extract covered 20 taxable quarters, that is, the quarters ending March 31, 1981, through December 31, 1985. For each taxable quarter, the tape extract provided each applicable taxpayer's name, address, and identification number (employer identification number or social security number). Based upon unique taxpayer identification numbers, we identified 2,293 sporting goods excise tax return filers for the 5-year period.

IDENTIFYING MANUFACTURERS AND IMPORTERS

To determine which of the 2,293 filers were manufacturers and which were importers, we first printed out the names (in alphabetical order) and addresses from the BMF tape extract. We then manually matched this list with various federal and private sector data sources that identified manufacturers and importers of sporting goods. Federal sources included a

- Bureau of Alcohol, Tobacco and Firearms (BATF) listing of the names and addresses of the entities and individuals issued licenses for manufacturing and importing firearms and ammunition (13,400 current licenses as of December 31, 1985, and about 4,400 licenses that expired during the period January 1983 to May 1986) and
- U.S. Customs Service listing of importers of archery equipment for fiscal years 1983 to 1985.

The private sector sources we used to identify manufacturers and importers included the following:

- Electronic Yellow Pages - Manufacturers Directory. This on-line directory is compiled by DIALOG Information Services, Inc. (Palo Alto, California) from information provided by Market Data Retrieval, Inc. (Westport, Connecticut). The latter company generates the data using about 4,800 telephone books and special directories from U.S. cities. We obtained an extract, as of September 1985, covering manufacturers of firearms, ammunition, archery equipment, and sporting goods.
- Gun Digest, 1985. This reference source, published annually by DBI Books Inc. (Northfield, Illinois), contains a directory of manufacturers and importers of firearms and ammunition.
- Thomas Register, 1985. This on-line service, produced by Thomas Publishing Co. (New York, New York), alphabetically lists manufacturers of products and providers of services. We obtained an extract of U.S. manufacturers of firearms, ammunition, and archery equipment.
- Eighth Annual Shot Show Directory, 1986. This directory was published by Cahners Exposition Group (Stamford, Connecticut), on behalf of the National Shooting Sports Foundation (Riverside, Connecticut), which sponsors the Shot Show. The directory lists all participants in the annual shooting and hunting trade show, which includes manufacturers and importers of sporting arms and ammunition, and archery equipment.

We were referred to these sources by trade associations, such as the Sporting Arms and Ammunition Manufacturers Institute (Bramford, Connecticut), the American Archery Organization (North Palm Beach, Florida), and the Wildlife Management Institute (Washington, D.C.).

As shown in table II.1, using the sources described above, we were able to identify 812 names listed on the BMF extract of sporting goods excise tax return filers as either manufacturers, importers, or both. After adding manufacturer and importer identifiers to the BMF alphabetical listing of excise tax filers, we prepared a computer tape containing this data.

COMPARATIVE AUDIT
COVERAGE STATISTICS

We provided IRS' Detroit Data Center with the computer tape of the 812 taxpayer identification numbers and with codes designating these taxpayers as manufacturers, importers, or both. Programming and computer personnel at the Detroit Data Center matched this tape with AIMS files for examinations completed in fiscal years 1983, 1984, and 1985 to produce tables I.1, I.2, and I.3.

As table II.1 shows, for over one-half of the 2,293 sporting goods excise tax return filers shown on the BMF extract, we were unable to determine whether the filers were manufacturers or importers. Consequently, the AIMS files for fiscal years 1983 to 1985 contained sporting goods examination information (covering 69 taxpayers and 284 quarterly excise tax returns) which we did not use in developing tables I.1, I.2, and I.3.

Table II.1: Results of GAO Efforts to Identify Sporting Goods Excise Tax Return Filers as Manufacturers and Importers

<u>Category</u>	<u>Sporting goods excise tax return filers on BMF extract</u>	
	<u>Number</u>	<u>Percentage</u>
Manufacturers	635	27.7
Importers	118	5.1
Both ^a	59	2.6
Subtotal	<u>812</u>	<u>35.4</u>
Oil and gas companies ^b	254	11.1
All others ^c	1,227	53.5
Total	<u>2,293</u>	<u>100.0</u>

^aThese 59 entities or individuals are not included in the figures for manufacturers (635) or importers (118).

^bDue to taxpayer and/or IRS errors, these 254 companies were included in the BMF extract as sporting goods excise tax return filers. These errors may have occurred because the line item for shells and cartridges on the Form 720 return is adjacent to the line item for gasoline. IRS modified the Form 720 return (effective for the quarter ended March 31, 1986) to prevent this type of transposition error.

^cUsing the federal and private sector sources previously mentioned, we were unable to obtain specific information on these entities or individuals identified by the BMF as filers of sporting goods excise tax returns. About 118 of these names appeared related to businesses other than sporting goods (e.g., truck parts, construction, and trailers); however, using our sources, we could not specifically determine whether these excise tax return filers were miscategorized in the BMF.

IRS FORM 720:
QUARTERLY FEDERAL EXCISE TAX RETURN

Form 720
(Rev. October 1985)

Department of the Treasury—Internal Revenue Service
Quarterly Federal Excise Tax Return
For Paperwork Reduction Act Notice, see instructions.

OMB No 1545-0023

Use to Report Excise Taxes for 1985

Please enter your name, address, employer identification number, and calendar quarter of return, if not preprinted. (If not correctly printed, please change.)

Quarter ending

Employer identification number

Table with 2 columns: Category (T, FF, FD, FP, I, T) and Amount.

If address is different from prior return, check here.

Note: Be sure to enter the tax on the correct line to ensure proper credit.

Part I Computation of Tax Items

Part II Computation of Net Tax Liability

Table with 4 columns: Description, Rate, Tax, and IRS No. Includes categories like Facilities and Services Taxes, Manufacturers Taxes, Retail and Use Taxes, and Environmental Taxes.

Table with 2 columns: Line Number and Description. Includes instructions for total tax, adjustments, record of tax liability, and total liability for quarter.

*See instructions on pages 2 and 4 through 6

Under penalties of perjury, I declare that I have examined this return, and accompanying schedules and statements, and, to the best of my knowledge and belief, they are true, correct, and complete

Signature

Title (Owner, etc.)

Date

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