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TAX ADMINISTRATION

Compliance and Other Issues Associated With Occupational Excise Taxes

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The Honorable Bob Packwood
Chairman, Joint Committee on Taxation

The Honorable Dan Rostenkowski
Vice Chairman, Joint Committee on Taxation
Congress of the United States

This report discusses the need for improving taxpayer compliance with the occupational excise taxes on alcohol and wagering. The report also presents matters the Congress may wish to consider relating to the taxes on retail alcohol dealers and dealers of National Firearms Act weapons. We prepared this report because of the inherent difficulty administering agencies have in developing cost-effective strategies for enforcing these taxes.

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of the Treasury; the Commissioner of Internal Revenue; the Director, Bureau of Alcohol, Tobacco and Firearms; and other interested parties.

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Director

Executive Summary

Purpose

Occupational and related excise taxes are imposed on businesses and individuals in the alcohol, wagering, and firearms industries to generate federal revenue and to control the taxed activities. These taxes generated over $34 million and $28 million during fiscal years 1983 and 1984, respectively.

Because of the inherent difficulty in mounting cost-effective enforcement strategies, GAO studied taxpayer compliance with most of the occupational taxes and evaluated how well the Internal Revenue Service (IRS) and the Bureau of Alcohol, Tobacco and Firearms (Bureau) were carrying out their tax administration responsibilities.

Background

Most occupational taxes are due annually and they vary in amount from $24 to $500 depending on the occupation of the taxpayers. Alcohol taxes are imposed on brewers and on wholesale and retail dealers. The wagering taxes apply only to certain types of wagering activities, are levied on both businesses and individuals accepting wagers, and the rates differ depending on whether the wagering activities are authorized by state law. Firearms taxes are levied on importers, manufacturers, and dealers of National Firearms Act controlled weapons such as machine guns, silencers, sawed-off shotguns, and destructive devices. (See pp. 10 to 15.)

Related excise taxes also apply to certain wagering and firearms transactions. For wagering, a percentage tax, which is due monthly and differs for authorized and unauthorized activities, is imposed on the gross amount of wagers accepted by a person in the business of accepting wagers. With certain exceptions a firearms tax is imposed on each controlled weapon made by or transferred to an individual.

Results in Brief

Occupational tax revenue is being lost due to noncompliance with the retail alcohol and wagering taxes. Noncompliance with the retail alcohol taxes resulted in a projected fiscal year 1983 revenue loss of between $1.8 million and $3.7 million in the four states GAO reviewed. GAO could not develop a projection for compliance with the wagering taxes because the population of liable taxpayers could not be readily identified.

The Bureau and IRS rely primarily on voluntary taxpayer compliance to collect occupational taxes on alcohol and wagering. Given the levels of noncompliance that GAO identified— particularly with the retail alcohol

taxes—GAO believes that the Bureau, IRS, and/or the Congress should take actions to address taxpayer compliance.

GAO's analysis of tax-free weapon transfers in two states suggests, however, that some individuals may be paying the annual dealer tax in order to avoid the tax which would otherwise apply to individual weapon transactions.

Principal Findings

Alcohol Taxes

In a four-state review, GAO found that 4 of every 10 retail alcohol establishments had not paid the required $24 or $54 occupational tax Taxes during fiscal year 1983. (See p. 21.) The Bureau agrees that additional compliance efforts are needed and has initiated a special tax collection program to increase compliance and tax collections. (See p. 31.) The Bureau also drafted, and the Department of the Treasury and the Office of Management and Budget approved, a legislative proposal that would restrict wholesalers' sales of alcoholic beverages to only those retailers that could prove that they paid their occupational taxes. (See pp. 21 and 28.) GAO agrees that the Bureau's special program and legislation along the lines proposed could increase compliance. GAO believes, however, that the Bureau should take additional steps to improve compliance. (See pp. 29 and 30.)

Wagering Taxes

Although information is available to identify some liable taxpayers, IRS does not use it to detect noncompliance.

GAO found that information from states that license wagering establishments can be used to assess compliance by businesses with the occupational tax and the tax due monthly on wagers accepted. In other states, a limited assessment of compliance can be made by comparing the occupational tax payment records with the tax on wagers records to determine whether businesses complied with each filing requirement. In addition, an information reporting requirement already exists which, if enforced by IRS, would identify individuals liable for the occupational tax. (See pp. 35 to 37.)

Firearms Taxes

GAO's two-state analysis of tax-free transfers of National Firearms Act weapons, although not definitive, suggests that a reevaluation of the provision allowing tax-free weapon transfers between occupational taxpayers may be needed. An economic incentive exists for individuals who expect to engage in more than one weapon transaction in a year to pay the $200 dealer tax. By so doing, they can avoid the $200 per weapon tax on transfers between individuals or between a dealer and an individual. GAO's sample of 114 current and former dealers in two states showed that 58 purchased, but never sold, the 279 weapons they acquired. (See p. 45.)

Recommendations

To increase compliance with the retail alcohol occupational taxes, GAO recommends that the Director, Bureau of Alcohol, Tobacco and Firearms arrange for

(1) IRS to assist in identifying potentially noncompliant retailers by matching occupational tax records with business income tax return information and

(2) State and local licensing agencies to provide BATF with names of newly licensed establishments and advise these establishments of their occupational tax liabilities. (See p. 30.)

GAO also makes recommendations to the Director regarding certain individuals who discontinue their status as dealers in National Firearms Act weapons. (See p. 52.)

To increase compliance with the wagering taxes, GAO recommends that the Commissioner of Internal Revenue use information that is on hand and which can be readily obtained to identify individuals and businesses liable for paying wagering taxes. GAO also makes a recommendation to the Commissioner regarding the monthly filing requirement for the tax on gross wagers. (See p. 40.)

Matters for Consideration by the Congress

In recognition of the inherent difficulties in devising cost-effective approaches for enforcing the retail alcohol occupational taxes, the Congress may wish to reassess the continued need for the taxes or, alternatively, consider enacting legislation requiring that wholesalers only deal with retailers who can provide proof of payment of their taxes.

The information GAO has developed on tax-free weapon transfers suggests that the Congress should consider whether and, if so, how the incentive that exists for individuals to obtain dealer status to avoid the per weapon transfer tax should be reduced or eliminated. GAO presents four alternatives for congressional consideration. (See p. 53.) The Bureau has also developed alternatives. (See p. 83.)

Agency Comments

Bureau

The Bureau agreed with the thrust of GAO's recommendations for increasing compliance with the retail alcohol occupational taxes. The Bureau initiated a special tax collection program which embodies GAO's recommendation on the use of nonfederal licensing data. GAO believes that its recommendation relating to matching occupational tax records with income tax return information should also be implemented to strengthen the Bureau's program. (See p. 31.)

The Bureau reiterated its opposition to the repeal of the retail alcohol occupational taxes because it believes repeal would have a detrimental effect on its overall law enforcement effort. (See p. 75.) GAO does not take a position on repeal, but does believe it is a matter worth consideration by the Congress.

IRS

IRS agreed that GAO's recommendations would increase compliance with the wagering taxes but did not believe there would be a significant enough impact on either voluntary compliance or revenues to justify implementation. IRS believed its limited resources would be more productively utilized in other areas. GAO agrees that resources should be prioritized, but also believes that the actions recommended would be a cost-effective use of IRS' resources. To the extent that IRS, because of higher priority work, cannot take these actions, it should advise the Congress. The Congress could then, in light of the competing demands for limited government resources, either endorse IRS' management decision or take other actions. (See p. 40.)

Contents

Figures

Abbreviations

BATF	Bureau of Alcohol, Tobacco and Firearms
CIP	Crime Impact Program
GAO	General Accounting Office
IRC	Internal Revenue Code
IRS	Internal Revenue Service
NFA	National Firearms Act
PIA	Principal Industry Activity
PPSSCC	President's Private Sector Survey on Cost Control

Introduction

The federal government levies 14 occupational and related excise taxes on certain trades or businesses involved in the alcohol, firearms, and wagering industries. Occupational taxes are special excise taxes which are used as (1) a source of revenue and (2) a vehicle to control the taxed activities.

The 14 occupational and related excise taxes, which for simplicity we will generally refer to as occupational taxes, are administered by agencies of the Department of Treasury. The Bureau of Alcohol, Tobacco and Firearms (BATF) administers the alcohol and firearms occupational taxes. The Internal Revenue Service (IRS) administers the wagering taxes and assists BATF by collecting some of the alcohol and firearms taxes.

Alcohol Occupational Taxes

Alcohol occupational taxes must be paid before a business can legally engage in the sale of alcoholic beverages as a (1) retail or wholesale dealer; (2) manufacturer of non-beverage alcoholic products (flavor extracts, cough medicines, etc.); and/ or (3) brewer. The tax rates differ by occupation and range from $24 per annum for a beer retailer[1] to $255 per annum for a wholesale liquor dealer.

Taxpayers are required to annually file an alcohol occupational tax return and the applicable tax payments with designated IRS service centers. If a business is conducted in more than one location, the tax must be paid for each location. However, state-operated alcohol establishments are required to pay one tax regardless of the number of locations operated.

Tax returns and payments are due on July 1 of each year and cover the period through the following June 30. Upon receipt of the tax return and applicable payment, IRS issues a tax receipt (referred to as a "tax stamp") to signify proof of payment.

Alcohol occupational taxes have long been used by the federal government to generate revenue. In 1794, a $5 per annum tax was imposed upon retail dealers in wine and domestic dealers in foreign-produced distilled spirits. The taxes were repealed in 1817. In the 1860's, alcohol occupational taxes were again instituted and have remained in effect ever since.

[1] In lieu of the annual tax, organizations that sell alcoholic beverages for a limited time at fairs, picnics, carnivals, etc. may pay a monthly tax of $4.50 or, if only sales of beer and wine are made, $2.20.

Wagering Occupational Taxes

Wagering occupational taxes were first enacted with passage of the Revenue Act of 1951. Wagering taxes are of two types. The first is an annual tax on businesses and individuals accepting certain types of wagers. The second type is a tax on the gross wagers accepted (referred to as the tax on gross wagers) and is assessed on the business. The taxes apply whether or not the wagering activities are authorized by state law.

Gambling subject to the taxes includes wagers placed on lotteries, betting pools and sporting events or contests. The law exempts certain activities, such as state licensed parimutuel wagering, state conducted lotteries, coin operated gambling devices, and most activities conducted by tax-exempt organizations. In addition, activities which require all winners to be present are exempt from the taxes. Therefore, activities such as bingo and keno and more traditional casino gambling (black jack, roulette, etc.) are exempt.

The tax rates vary depending on whether the wagering activities are authorized by state law. The annual occupational tax is $500 except for state authorized activities which are subject to a $50 tax.[2] The tax on gross wagers is 2 percent of the gross wagering revenue received except for state authorized activities, which are subject to a tax of 0.25 percent of gross wagering revenue.

The annual tax on all businesses and persons accepting wagers is due on July 1 and covers the tax period through June 30. The tax on gross wagers, which applies to anyone engaged in the business of accepting wagers, is required to be filed monthly with the IRS even if no taxes are owed.

Firearms Occupational Taxes

Firearms occupational taxes were created by the National Firearms Act (NFA) of 1934, as amended. The taxes are levied on manufacturers, importers, and dealers of NFA weapons. NFA weapons include machine guns, silencers, sawed-off shotguns, sawed-off rifles, destructive devices (bombs, grenades, etc.), and specialty weapons referred to as "any other

[2]At the time of our review, wagering activities in two states, Nevada and Washington, qualified for the lower tax rates applicable to state authorized wagering.

weapons."[3] The occupational taxes are $500 per annum for manufacturers and importers, and $200 per annum for dealers except for manufacturers, importers, or dealers of "any other weapons" which are annually taxed at the rates of $25, $25, and $10, respectively.

In addition to the per annum tax on manufacturers, importers, and dealers of NFA weapons, related excise taxes are also levied for each weapon made[4] by or transferred[5] to an individual. The per weapon making tax is $200. The transfer tax is $200 per weapon except for the "any other weapon" category which is taxed at $5 per weapon transferred. Weapons transferred between occupational taxpayers, however, are exempt from the tax as are transfers to federal, state, and local government entities.

Like the alcohol occupational taxes, the firearms occupational taxes are filed with the IRS service centers and cover the July 1 through June 30 tax period. The per weapon transfer and making tax forms and payments are filed directly with the National Firearms Branch at BATF headquarters because prior approval of these transactions is required.

The NFA is one of several laws passed in the late 1920's and early 1930's to combat the crime of the era. The law was designed to discourage private ownership of machine guns and other dangerous weapons and to provide a means for convicting individuals found to be illegally possessing the weapons.

The Congress was concerned whether a federal ban on such weapons would be unconstitutional and, therefore, chose to regulate possession of these weapons through the tax code. The making of an NFA weapon by an individual or dealer and any transfer of an NFA weapon must be approved by the Secretary of the Treasury (or his/her designee) prior to consummating the transaction. The Secretary insures the proper tax is

[3]"Any other weapon" is defined as any weapon or device having a barrel with a smooth bore and not designed to be fired from the shoulder or not capable of firing conventional ammunition (e.g., guns made from pens, pencils, and canes).

[4]"Making" includes the manufacture of a new NFA weapon and converting an existing weapon such that it meets the criteria to qualify as an NFA weapon.

[5]"Transferred" means selling, assigning, pledging, leasing, loaning, giving away or otherwise disposing of the weapon.

paid, possession is allowed by state and local law, and the applicant is qualified to possess the weapon.[6]

By taxing each weapon made or transferred at a rate, in 1934, approximately equal to the purchase price, the Congress hoped the cost would be sufficiently high enough to discourage private ownership. In addition, since payment of the tax serves to also register the weapon, the Congress believed criminals would not comply with this law, thereby subjecting themselves to a felony violation for illegal possession of the weapons. At the time of our review, about 195,000 NFA weapons were legally registered with BATF. (See apps. I and II.)

Occupational Tax Revenue

The federal occupational taxes generated $34.8 million and $28.9 million in fiscal years 1983 and 1984 respectively. Table 1.1 shows the tax rates and the amounts of revenue collected from each type of tax during the two years.

[6]Qualification criteria includes determining whether the prospective transferee is a U.S. citizen, is not a convicted felon, is not mentally incompetent, is not a drug addict, and was not dishonorably discharged from the armed forces.

Table 1.1: Occupational Tax Rates and Collections

Type of tax	Annual tax rate	Internal Revenue Code section	Collections Fiscal Year 1983	1984
Alcohol:				
Retail liquor	$ 54	5121(a)	$18,009,752	$17,227,277
Retail beer	$ 24	5121(b)	1,708,379	1,488,121
Wholesale liquor	$255	5111(a)	1,464,246	1,495,403
Wholesale beer	$123	5111(b)	486,616	428,890
Limited dealer[a]	[b]	5121(c)	15,924	19,451
Brewer:				
Less than 500 barrels	$ 55	5091	2,042	14,747
500 or more barrels	$110	5091	19,718	10,388
Non-beverage alcohol manufacturers	[c]	5131(b)	83,137	83,023
Subtotal			**$21,789,814**	**$20,767,300**
Wagering:				
Occupational:			$1,376,966[d]	$897,176
Authorized	$ 50	4411(b)		
Unauthorized	$500	4411(a)		
Tax on wagers:			10,467,104[d]	5,966,398
Authorized	0.25%	4401(1)(a)		
Unauthorized	2.00%	4401(2)(a)		
Subtotal			**$11,844,070**	**$6,863,574**
Firearms:[e]				
Occupational:			$ 591,400[f]	$ 595,645
Manufacturers	$500	5801		
Importers	$500	5801		
Dealers	$200	5801		
Per weapon:			$ 594,250[g]	$ 666,410[h]
Transfer	$200	5811(a)		
Making	$200	5821(a)		
Subtotal			**$ 1,185,650**	**$ 1,262,055**
Total			**$34,819,534**	**$28,892,929**

[a]Fraternal, civic, church or similar types of organizations which sell alcoholic beverages for a limited time at fairs, picnics, carnivals, etc.

[b]Rates per month for limited sales: liquor $4.50; beer or wine $2.20

[c]Rates vary from $25 to $100 depending on the number of gallons used.

[d]IRS records do not separate the amounts of revenue received by authorized and unauthorized activities.

[e]Rates for "any other weapons": The occupational tax is $25 for manufacturers and importers and $10 for dealers. The per weapon making tax is $200 and the per weapon transfer tax is $5.

[f]IRS records do not separate the amounts of revenue by manufacturers, importers, and dealers.

[g]BATF records did not separate the amounts of revenue by transfer or making in fiscal year 1983.

[h]Transfer and making tax revenues were $587,210 and $79,200 respectively.

Objective, Scope and Methodology

Our objective was to assess the efficiency and effectiveness of the administration of federal occupational excise taxes. We focused primarily on whether all liable taxpayers were being identified and the proper taxes were being assessed. We also gathered information on the use of the taxes as a criminal law enforcement mechanism to gain a broader perspective of the overall objectives served by the taxes.

We reviewed IRS' and BATF's policies, procedures and practices for administering the occupational excise taxes, and analyzed records of tax payment and registration information. We interviewed IRS national, regional, service center, and district office personnel involved in the collection, criminal investigation, and examination functions and BATF national, regional, and area office personnel involved in the law enforcement and compliance functions.

This work was performed at:

- BATF and IRS headquarters in Washington, D.C.;
- BATF and IRS regional offices in Atlanta, Chicago, Dallas, and San Francisco;
- IRS service centers in Austin, Texas; Chamblee, Georgia; Fresno, California; Kansas City, Missouri; and Ogden, Utah; and
- BATF and IRS district offices in Atlanta, Austin, Chicago, Dallas, Los Angeles, Miami, Reno, and Seattle.

These federal offices are responsible for administering the taxes for the states we selected for detailed review.

We also interviewed officials from the Department of Justice and analyzed samples of BATF and IRS case files to determine how the tax laws are used for law enforcement purposes. In addition, we reviewed federal court cases which have affected the administration and enforcement of occupational taxes. Finally, we interviewed state tax collection and law enforcement personnel, alcohol trade association representatives, and firearms interest group spokespersons.

States Included in Our Review

The states included in our detailed review differed depending on the type of tax. Our basic approach was to select high dollar volume states for review which also maintained data that could be used to identify liable taxpayers.

Alcohol taxes - We selected the states of California, Florida, Illinois, and Texas for review because they are four of the largest states in terms of alcohol occupational tax revenue generated. Combined, these four states generated $6.1 million, or 28 percent, of the $21.8 million of the alcohol occupational taxes paid in fiscal year 1983. Also, these states had centralized and computerized data bases necessary to obtain and compare state alcohol license data with federal tax data.

Wagering taxes - We selected the states of Nevada and Washington for review because, together, they generated $7.5 million, or 63 percent, of the $11.8 million wagering taxes generated nationwide in fiscal year 1983. Also, gambling license data were available from these states to use in determining compliance with the wagering taxes. Our compliance study was aimed at determining whether liable taxpayers were filing returns. We did not attempt to identify taxpayers who filed but underpaid their taxes. Also, we did not measure compliance with unauthorized activities other than on a limited basis because neither we nor IRS could determine the extent of such activities. In this regard, we selected some returns filed by taxpayers from states that do not authorize wagering to make a limited assessment of compliance by taxpayers engaged in unauthorized activities. To get an indication of how the wagering taxes are used by IRS for law enforcement purposes, we reviewed cases developed by the Dallas Criminal Investigation Division. Dallas was chosen because, according to IRS data, that office develops more criminal wagering tax cases than any other IRS district.

Firearms taxes - We selected the states of California and Louisiana for our review of compliance with the annual occupational tax because they are the only states that issue dealers, manufacturers, and importers a special license to deal in NFA weapons. We used the licensing data obtained from these states as a basis for measuring compliance with the federal firearms occupational taxes.

At the suggestion of BATF, we analyzed case files for illegal possession of NFA weapons in Florida and Illinois. According to BATF, the cases developed in these two states portray how the agency uses the tax code to prosecute suspected crime figures.

In addition, we analyzed tax-free transfers of NFA weapons in Florida and Illinois to obtain an indication of the number of NFA dealers actually engaged in the business of selling NFA weapons.

We used various samples to measure compliance with the alcohol, firearms, and wagering taxes. The methodology for each sample is presented in appendix III.

Review Limitations

Although this study is a comprehensive review of the occupational and related taxes levied by the federal government, it does not address three specific areas: limited retail dealer alcohol taxes, non-beverage manufacturers' taxes, and overall compliance by individuals or businesses involved in unauthorized activities.

We did not review the limited retail alcohol taxes because data was not readily available to identify liable taxpayers for measuring compliance. None of the four states included in our alcohol compliance studies maintained computerized licensing information for limited dealers.

We also did not review the occupational tax on manufacturers of non-beverage alcoholic products such as flavor extracts and cough medicines. None of the four states included in our review license these businesses and therefore data was not readily available to identify liable taxpayers. We noted, however, that the method used for imposing the tax on non-beverage manufacturers virtually assures compliance. Non-beverage manufacturers buy distilled spirits from distillers and are required to pay the $10.50 per gallon excise tax to the distiller. When the spirits are converted into non-beverage form, the manufacturer can apply to IRS for a rebate of $9.50 per gallon, provided proof of payment of the occupational tax is presented. Because the maximum occupational tax is $100 per year, it is unlikely that a non-beverage manufacturer would forego the per-gallon rebates to avoid the annual occupational tax.

Although unauthorized activities are subject to the same type of taxes as authorized activities, our compliance studies are based primarily on the legal activities. Because the extent of illegal activities is unknown and impractical for us to determine or estimate, our estimates of taxpayer compliance and lost revenue relate primarily to legal or authorized activities.

Our review was conducted between February 1983 and May 1985 and was performed in accordance with generally accepted government auditing standards.

Alcohol Occupational Taxes: Need to Increase Compliance With the Retail Taxes

Improvements in the enforcement of retail alcohol occupational taxes would result in additional tax revenue. Our four-state sample showed that about 40 percent of the retail alcohol establishments did not pay their 1983 alcohol occupational taxes. Our projection of the sample results showed that between 50,468 and 70,010 retailers in the four states were delinquent with a resulting annual revenue loss of $1.8 million to $3.7 million. Wholesalers and brewers in the four states, on the other hand, had compliance rates of 92 percent and 100 percent, respectively.

However, the enforcement of retail alcohol occupational taxes presents a dilemma. Noncompliance by retailers is resulting in lost revenue, yet given the relatively low tax rates and large number of liable taxpayers, labor intensive compliance measures are generally not cost effective. Consideration of measures to reduce or eliminate noncompliance must, therefore, take into account these inherent features.

Compliance With the Wholesaler and Brewer Occupational Taxes

Compliance by wholesalers and brewers with the alcohol occupational taxes appears considerably higher than compliance by retailers. BATF officials attribute the higher compliance to the fact that state alcohol licensing agencies require wholesalers and brewers to obtain federal permits issued by BATF prior to issuing the applicant's state licenses. When obtaining the federal permits from BATF, the applicants are advised of their occupational tax requirement and are, therefore, more likely to comply according to BATF officials. Such is not the case for retail dealers.

Based on our four-state random sample of brewers and wholesalers, we found compliance rates of 100 and 91.6 percent respectively. Table 2.1 shows the results of our wholesaler sample.

Table 2.1: Compliance by Sampled Wholesale Alcohol Dealers

State	Number of state licensed wholesalers	Number sampled	Compliant wholesalers	
			Number	Percent
California	977	64	57	89.1
Florida	209	46	41	89.1
Illinois	334	52	50	96.2
Texas	751	46	43	93.5
Total	**2,271**	**208**	**191**	**91.6**

Projecting the results of this sample, between 98 and 284 of the 2,271 licensed wholesalers operating in the four states are delinquent resulting in an annual revenue loss of $24,990 to $72,420 in the four states. (See app. III.)

BATF assisted us in the determination of delinquent wholesalers and in some cases made an immediate assessment and collection of delinquent taxes, penalties, and interest. At the time of our review, about $18,000 was assessed or collected from the 17 delinquent wholesalers. Additional amounts will also be assessed when the final calculations of penalties and interest due are made.

Compliance With the Retail Alcohol Occupational Taxes

Every retail establishment that sells alcoholic beverages is required to pay the yearly occupational tax before engaging in business. Our four-state sample showed that about 40 percent[1] had not paid their occupational taxes. We sampled 943 of the 151,131 retail establishments operating in the four states. With BATF's assistance, we determined that 344 were delinquent and that 162, or almost one-half of them, were delinquent for 3 or more years. Table 2.2 shows the results of our four-state sample.

Table 2.2: Compliance by Sampled Retail Alcohol Dealers

State	Number of state licensed retailers	Number sampled	Compliant retailers	Delinquent retailers
California	58,040	202	108	94
Florida	27,583	341	238	103
Illinois	21,869	188	130	58
Texas	43,639	212	123	89
Total	**151,131**	**943**	**599 (60.1%)[a]**	**344 (39.9%)[a]**

[a]The percentages of compliant and delinquent retailers are weighted projections based on the number of licensed establishments in each state. (See app. III.)

On the basis of our sample, we project that between 50,468 and 70,010 of the licensed retailers operating in the four states were delinquent and we estimate the annual revenue loss is between $1.8 million and $3.7 million in the four states.

[1]Our four state sample did not include fraternal organizations and one class of off-sale (i.e. alcoholic beverages may be purchased but not consumed on the premises) establishments in Florida (see sampling methodology in app. III).

For those actually identified as delinquent in our sample, BATF in some cases made immediate assessments and collections of taxes, penalties, and interest due. At the time of our review, about $107,000 had been assessed or collected. Additional amounts will be assessed and collected after IRS makes final determinations of interest and penalties due.

We were unable to determine the exact reasons why the taxpayers had not paid their taxes. Over 70 percent (251 of 344) of the delinquent taxpayers in our sample, when asked why they had not paid their taxes, told BATF inspectors, as might be expected, that they were unaware of their tax liability.

Three previous studies conducted by GAO, IRS, and the President's Private Sector Survey on Cost Control (PPSSCC) also identified the existence of noncompliance with the retail alcohol occupational taxes. The previous GAO study,[2] conducted in 1975, estimated a 27 percent noncompliance rate based upon a four-state sample—California, Georgia, Illinois, and Ohio. The IRS study, which estimated noncompliance of 35 percent within the Little Rock, Arkansas District, was based on a study during 1983 and 1984 by its collection division. The PPSSCC study, which estimated 60 percent noncompliance nationwide, was conducted in 1983 and was part of a larger governmentwide review.

BATF Is Aware of the Noncompliance With Retail Alcohol Occupational Taxes

BATF recognizes that a compliance problem exists with the retail occupational taxes and believes the 40 percent noncompliance found in our study is probably representative of noncompliance nationwide. BATF believes the present compliance level is unacceptable and that additional enforcement tools and resources are needed to improve compliance.

BATF believes 95 percent to be an acceptable compliance level for retail alcohol occupational taxes. However, it acknowledges that the level of compliance is directly tied to the level of resources expended in the area. Currently, BATF relies primarily on taxpayer awareness programs to increase compliance. These programs include placing advertisements on the occupational tax in trade journals and arranging for states to distribute information on the occupational tax along with state alcoholic beverage licensing materials. In addition, BATF occasionally verifies whether retail alcohol establishments have paid their taxes when visiting the establishments for other purposes.

[2]Occupational Taxes On the Alcohol Industry Should Be Repealed (GGD-75-111, Jan. 16, 1976.)

BATF does not believe that these approaches will adequately deal with existing noncompliance. During March 21, 1984, Senate Appropriations Committee hearings, BATF was asked the question of whether and, if so, what additional compliance efforts were needed. In responding for the hearing record, BATF stated:

"The Grace Commission [PPSSCC] has made a recommendation that wholesalers of alcoholic beverages (already required to hold Federal permits and pay wholesaler special tax) be required to check that retailers have paid the special occupational tax prior to selling to the retailers. As a statutory change would be required to implement this recommendation, ATF has prepared a draft bill and submitted it to the Department of Treasury for subsequent action.

Apart from this Grace Commission [PPSSCC] recommendation, ATF believes increased enforcement efforts should now be applied to this program to reverse this trend of noncompliance. ATF will request additional resources in next year's budget request in an effort to improve retail special occupational tax compliance and effect the collection of $3 million from about 20,000 delinquent retailers in the first year, with additional collections in future years. This collection effort would also increase our visibility in this area and would result in increased industry compliance."

We agree that additional resources and legislation along the lines recommended by the PPSSCC would help to increase compliance. However, BATF did not receive approval for additional resources and there is no legislation relating to retail occupational taxes pending before the Congress. Further, in reaction to staffing and budget reductions in the past, BATF directed all compliance enforcement efforts from retail occupational taxes to areas it considered to be of higher priority.

We note that BATF is considering a one-time effort to increase compliance. It would involve matching data on retail alcohol establishments with occupational tax payment records to identify potentially delinquent taxpayers. The Deficit Reduction Act of 1984, which increases the excise tax on distilled spirits, requires all wholesale and retail establishments to file a tax return by April 1, 1986, stating the volume of alcoholic beverages on hand as of October 1, 1985, and to remit any additional taxes owed. Establishments which do not owe additional taxes are still required to file the tax return stating that no additional taxes are owed.

In anticipation of the receipt of these returns, BATF is developing plans for obtaining state alcohol licensing data which would then be matched against a list of alcohol establishments filing the April 1 returns and

against the occupational tax payment records. This cross matching procedure would serve to identify establishments that are potentially noncompliant with either or both tax requirements.

In its comments on a draft of this report, BATF informed us of a special tax collection program that it intends to carry out to enhance compliance and increase tax collections. (See p. 31.)

Penalties for Noncompliance Serve Tax Administration and Other Law Enforcement Objectives

BATF uses both civil and criminal penalties to deal with noncompliance with the retail alcohol occupational tax laws. The civil penalties are monetary and are levied for failure to pay the occupational taxes and file the applicable tax return. Criminal offenses relate to willful failure to file the occupational tax return and filing of false statements on the occupational tax return.

BATF uses civil penalties primarily for tax administration purposes. It considers criminal penalties more appropriate and useful for accomplishing the broader law enforcement objective of preventing suspected criminals from infiltrating the retail alcohol industry.

Civil Penalties for Failure to Comply With the Occupational Taxes

Failure to file a return or pay the occupational taxes can result in a delinquent taxpayer, upon detection, being assessed up to two civil penalties. The particular circumstances of the case dictate which penalties are assessed. Potential penalties and the applicable Internal Revenue Code (IRC) sections are:

- Failure to file a tax return (other than fraud)—5% per month of the tax due not to exceed 25% of the total taxes owed. (IRC section 6651(a)(1)).
- Failure to pay the tax—0.5% of the tax underpayment per month not to exceed 25% of the total taxes owed. (IRC section 6651(a)(2)).

In addition, the delinquent taxes plus applicable penalties are generally subject to interest compounded daily. The interest rates are established semi-annually by the Secretary of the Treasury in relation to the prime lending rate as determined by the Federal Reserve Board.

Criminal Penalties for Failure to Comply With the Occupational Taxes

Criminal penalties are also available for dealing with taxpayers who fail to comply with the occupational tax requirements. One penalty pertains to a taxpayer's willful failure to pay the occupational tax which can be punishable with a fine of up to $5,000 and/or up to 2 years in prison.

Two other penalties relate to the failure to fully comply with the occupational tax form requirements.

BATF considers the criminal penalties most appropriate and useful in cases involving hidden ownership or hidden interest in alcohol establishments. These situations arise where individuals with an ownership or financial interest are not, as required, listed on the occupational tax form. Failure to comply with this requirement may result in (1) perjury (filing a false statement) punishable with a fine of up to $100,000 ($500,000 for corporations) or up to 3 years in prison, or both; and/or (2) conspiracy to defraud the government punishable with a fine of up to $10,000, or up to 5 years in prison, or both. According to BATF officials, suspected criminals are reluctant to disclose their identity on the form because the retail businesses are often used as a place to conduct illegal activities (e.g., selling narcotics, prostitution, etc.).

Through various means, BATF targets suspected criminals who are believed to have an ownership or financial interest in retail alcohol establishments. BATF then reviews the business' occupational tax form to determine if the suspected criminal is listed as having an interest in the establishment. If not, and an ownership or financial interest can be proven, then the omission on the tax form may be used to prosecute the individual.

In March 1983 testimony before the Senate Judiciary Committee, BATF officials stated that suspected criminals were infiltrating the alcohol industry. In January 1984, the BATF Assistant Director (Criminal Enforcement) sent memorandums to all BATF Special Agents in Charge requesting them to survey their jurisdictions to determine if alcohol occupational tax hidden ownership cases could be developed in their areas. According to the BATF official in charge of this special program, seven investigations were underway at the time of our review.

Alternative Approaches to Address Noncompliance With Alcohol Occupational Taxes

In view of the level of noncompliance we identified, and in recognition of the inherent difficulties in administering and enforcing the retail alcohol occupational taxes, we identified and assessed potential approaches for reducing or eliminating noncompliance. Presented below are alternative approaches and associated issues were they to be adopted. Neither the identified approaches or issues are intended to be exhaustive, but rather illustrative for the purpose of helping the Congress and BATF consider practical solutions to the noncompliance problem.

Increase Staff Resources Devoted to Enforcing the Occupational Taxes

A highly reliable approach to ensuring compliance with the occupational taxes involves visiting retail alcohol establishments to verify that the occupational tax was paid. BATF could identify and visit establishments when they are first licensed to conduct business within a state or local jurisdiction and establishments that stopped paying the tax but failed to adequately respond to IRS renewal and follow up notices. IRS sends renewal notices to current taxpayers and up to three followup notices if, after the July 1 due date, a taxpayer has not paid the tax or indicated that a tax liability no longer exists. IRS refers to BATF the names of establishments that did not adequately respond to the notices. Assuming that additional BATF correspondence with these establishments would be unproductive, BATF could make a visit to determine whether an establishment that stopped paying the tax was still liable and, if not, whether ownership changed to a new retail alcohol establishment.

BATF does not currently enforce the taxes through routine visits. According to BATF officials, existing resources can be used more productively in higher priority areas. In addition, they believe that, based on experience, site visits are not cost-effective in view of the annual turnover in the retail alcohol industry and the time and costs associated with making visits to collect a $24 or $54 tax per delinquent establishment.

We did not evaluate the prioritization and allocation of BATF's resources. We generally agree, however, that visits as a primary enforcement approach would be time consuming and costly. To illustrate, we will assume that the 40 percent noncompliance rate we found is representative of nationwide noncompliance. Based on BATF's estimate that about 450,000 retail alcohol establishments are liable for the occupational tax, 40 percent, or 180,000 establishments would be noncompliant. Given this number of noncompliant establishments, it seems reasonable to expect that, in the aggregate, a good deal of the $24 or $54 of tax collected per establishment would be consumed by the staff and travel costs involved.

Arrange for State and Local Governments to Collect the Taxes

Every retail establishment that sells alcoholic beverages in the United States is required to obtain some type of state or local license. Based on our four-state sample, about 40 percent of the establishments that obtained a state license to sell alcoholic beverages had not paid the applicable federal occupational tax. BATF could, therefore, increase compliance by arranging for state and local governments to collect the federal taxes for BATF in conjunction with the initial issue and renewal of state and local licenses.

A number of issues would need to be addressed in implementing this approach. First, on the basis of our discussions with officials of the four states included in our review, state and local governments may be reluctant to assist BATF unless they are adequately compensated and the federal, state, and local tax periods were made consistent. Second, 19 states do not license all retail alcohol establishments at the state level. Accordingly, BATF would need to make separate arrangements for dealing with local governments in these states. Third, some states would have to enact legislation to authorize the collection of federal taxes. For example, officials in three of the four states included in our review told us their present state laws would not allow them to collect federal taxes. Finally, existing intergovernmental relationships could be significantly altered depending on what action BATF would take in the event state and local governments issued their own licenses without collecting the applicable federal taxes.

Arrange for State and Local Governments to Require Proof of Payment of Federal Taxes Before Issuing Their Licenses

A variation of the preceding approach would have state and local governments deny applicants a license to sell alcoholic beverages unless they provide proof that the federal occupational taxes had been paid. The issues discussed under the preceding approach generally apply here as well. In addition, other significant and sensitive issues would emerge.

It may be very difficult for BATF to convince state and local governments to voluntarily commit themselves to this approach in view of the position they could be in of having to deny retail alcohol establishments the opportunity to conduct business within their jurisdictions for failure to comply with the $24 or $54 federal occupational tax.

Alternatively, BATF could pursue the enactment of federal legislation mandating this type of an enforcement role for state and local governments. Although not without precedent, such a legislative proposal could likely generate a significant federalism debate. States and local governments might view such a mandated role as an inappropriate intrusion in state and local affairs.

Match Nonfederal Licensing Information With Federal Occupational Tax Information

As previously indicated, every retail establishment that sells alcoholic beverages is required to obtain some type of state or local license. And, as shown by our sample, about 4 out of every 10 retail establishments that obtained a state license had not paid the applicable federal occupational tax. Accordingly, BATF could seek to identify potential delinquent establishments by providing IRS, or arranging for IRS to obtain,

nonfederal licensing information which could be matched against federal occupational tax payment records.

As with the preceding two approaches, the matter of states that do not issue all retail alcohol licenses at the state level would need to be addressed. Also, because the federal and nonfederal records do not always contain common identifying data, such as employer identification numbers, the match would identify as potentially noncompliant some retail establishments that had actually paid their taxes. For example, in our four-state sample, 47 percent of the potential noncompliant establishments we identified through this type of match, and referred to BATF for followup, were actually compliant.

Another issue involves the amount of followup effort that BATF should undertake once potential delinquent establishments are identified. Initially, BATF could follow up on establishments identified as potentially delinquent through correspondence or telephone contacts. If the establishments do not respond, BATF would need to determine whether other followup measures, such as visits to the establishments, should be undertaken. In making this determination, BATF faces a dilemma—making site visits, which it considers unproductive, or failing to follow through on what is an apparent tax delinquency. Assuming current staffing levels, BATF would probably opt not to make site visits to insure compliance. As previously discussed, BATF does not consider site visits a cost-effective enforcement approach.

Match Occupational Tax Payment Information With Other Federal Tax Information

Income tax returns filed with IRS by corporations, partnerships, and sole proprietorships provide for the recording of information as to the taxpayer's main or principal business activity. Using a standard list, either the taxpayer or IRS records for entry into IRS' computerized files, the code which most closely identifies the taxpayer's main or principal business activity. Two of the codes specifically pertain to retail alcohol establishments and a number of other codes potentially involve businesses that sell alcoholic beverages. BATF could arrange for IRS to match taxpayer identification numbers of businesses classified under two or more of these codes with occupational tax payment records to identify businesses that may be liable for, but did not pay, the occupational tax. Because this approach would not involve the matching of federal with nonfederal records, data incompatibilities should be minimized.

The PPSSCC recommended implementation of this type of an approach to increase compliance with retail alcohol occupational taxes. It specifically recommended that two Principal Industry Activity (PIA) codes be used in the match; code 5813 (drinking places) and code 5921 (liquor stores). Although a match of businesses classified under these two codes would undoubtedly identify establishments liable for paying the retail alcohol occupational taxes, other potentially liable establishments would not be identified. For example, restaurants that sell alcoholic beverages would likely have an assigned PIA code of 5812 (eating place).

We identified an additional 14 PIA codes that could involve businesses that sell alcoholic beverages. (See app. IV.) The more additional codes are matched, however, the more costly the matching program would be. Further, some unnecessary taxpayer contacts and taxpayer resentment may result.

Finally, as previously indicated, BATF would need to determine what, if any, additional followup efforts should be undertaken in cases where establishments identified as potentially liable for the taxes do not respond to whatever notices are generated as a result of the matching program.

Obtain Names of Newly Licensed Establishments and Inform Them of Their Federal Tax Liabilities

To insure that retail alcohol dealers are made aware of their occupational tax requirements, BATF could arrange for state and local governments to provide BATF with the names of newly licensed establishments. BATF could then contact the establishments and inform them of their tax liabilities. For example, during our review, BATF's Tampa, Florida, area office was contacting by telephone all newly licensed establishments in Florida to inform them of their tax liabilities. According to BATF officials, the assessments and collections realized under this approach exceeded the salary of the clerk making the calls.

Some of the issues discussed under preceding approaches would apply to this approach as well. They include the matter of compensating state and local governments for their costs in providing establishments' names to BATF; the fact that 19 states do not license all retail alcohol establishments at the state level; and what action BATF should take with regard to establishments that are informed of but do not meet their tax obligations.

Require That Wholesalers Only Deal With Retailers That Paid Their Occupational Taxes

This approach would involve requiring, as a condition of sale, that alcoholic beverage wholesalers only sell to retailers who can provide proof that they paid their occupational taxes. Wholesalers found to be dealing with retailers who had not paid the occupational taxes could be subjected to a suspension or revocation of their federal permits to deal in alcoholic beverages. The PPSSCC recommended the implementation of this approach. The PPSSCC's premise was that wholesalers would not, at the risk of permit suspension or revocation, deal with retailers who had not paid their taxes. In turn, retailers would have an increased business incentive to pay the $24 to $54 occupational tax and overall compliance with the taxes would increase accordingly. BATF has prepared and submitted draft legislation along these lines and, according to BATF, it has been approved by the Department of the Treasury and the Office of Management and Budget. BATF, in commenting on a draft of this report, said that the proposed legislation has been forwarded to the Congress but that, to date, it has not been introduced.

Alcohol industry representatives told us they are opposed to this approach because they do not believe private businesses should be required to enforce a federal tax law. In addition, industry representatives believe that the requirement would be difficult to meet because IRS is not always timely in issuing receipts (tax stamps) evidencing payment of the occupational tax.

Another issue BATF would face is how to deal with the 18 "controlled" states where a state agency is, in effect, the wholesaler. A sanction such as permit suspension or revocation could affect the sale of alcoholic beverages on a statewide basis. In contrast, the effect in other states would likely involve only one of a number of wholesalers operating within a given area.

Repeal the Alcohol Occupational Taxes

In our prior report[3] on alcohol occupational taxes, we noted that the taxes were not being adequately enforced and that repeal appeared preferable to additional enforcement. BATF opposed repeal primarily because it desired to use the penalty provisions for failure to comply with the taxes in dealing with suspected criminals it believed were infiltrating the legal alcohol industry. BATF also believed that the tax revenue collected was significant and represented voluntary payments for which the cost of collection was relatively low.

[3]Occupational Taxes On the Alcohol Industry Should Be Repealed (GGD-75-111, Jan. 16, 1976.)

Regarding the value of the tax as a criminal enforcement tool, we expressed the opinion that elimination of the occupational tax would have no effect on BATF's efforts to combat organized crime. We noted that there was no legal requirement that all owners be listed on the occupational tax form and that the dearth of results from BATF's concealed interest cases was attributed primarily to the fact that the form was too limited a document on which to base a successful prosecution. BATF has since revised the form to require that owners be listed and may have a more firm legal basis to seek prosecution of individuals with an ownership or financial interest that are not listed on the form. At the time of our review, BATF had seven hidden ownership/interest cases under investigation. (See p. 23.)

Although the ability of BATF to successfully pursue hidden ownership/interest cases may have been enhanced since our prior report, we continue to believe that the revenue objective of the tax, when viewed exclusively, would be better achieved through another taxing scheme. The inherent difficulty in collecting small amounts from a large number of alcohol establishments suggests that a more efficient approach, for example, would be increasing the tax rates for other excise taxes such as the per-gallon tax on distilled spirits and wine, and/or the per-barrel tax on beer. Whether the potential advantages of the occupational taxes from a criminal law enforcement standpoint outweigh the disadvantages from a tax administration standpoint, however, is a matter of policy for the Congress to consider.

Conclusions

Occupational tax revenue is being lost through noncompliance with the retail alcohol occupational taxes. Our four-state sample showed that 4 out of every 10 liable retail establishments were noncompliant. Past studies also identified revenue lost through noncompliance with the occupational taxes.

BATF believes an acceptable compliance level is 95 percent. To achieve this level, BATF believes it needs more enforcement resources and that legislation should be enacted that would restrict wholesalers' sales to retailers that could prove they paid their occupational taxes.

We agree that increased resources and additional legislative authority would likely increase compliance. We do not believe, however, that BATF should rely exclusively on obtaining additional budgetary resources or new legislation to address the existing noncompliance. We therefore evaluated several approaches to identify whether there appeared to be

any low labor-intensive, reasonable means to deal more immediately with the existing noncompliance.

In our opinion, two of the approaches we considered contain these characteristics. One approach, which is essentially that which was recommended by the PPSSCC, would involve matching federal occupational tax data with other federal income tax data to identify potential noncompliant retail alcohol establishments. The other approach involves obtaining information from state and local agencies on newly licensed retail alcohol establishments. Both approaches could rely primarily on telephone and correspondence contacts with identified establishments to ensure that the appropriate taxes have been paid. And these approaches, unlike the other approaches we considered which would involve states in the collection or enforcement of the taxes, would not alter existing federal/state relationships.

We also recognize the inherent difficulties in enforcing these taxes and in devising cost-effective ways to improve compliance. Accordingly, we present matters for the Congress to consider.

Recommendations

To increase compliance with the retail alcohol occupational excise taxes, we recommend that the Director, BATF,

- identify for followup potentially noncompliant retail alcohol establishments by arranging for IRS to match occupational tax payment data with businesses classified under selected principal industry activity codes and
- arrange for state and local alcoholic beverage licensing agencies to provide BATF with the names of new licensees and advise the licensees by telephone or correspondence of their federal tax liabilities.

Matters for Consideration by the Congress

Because some additional BATF resources, or a reallocation of existing resources, may be needed to increase compliance, and because of the inherent difficulty in collecting the retail alcohol occupational taxes—direct collection of small amounts from a large number of taxpayers—the Congress may wish to repeal the taxes.

BATF opposes the repeal of the retail alcohol taxes primarily because it is using the penalty provisions for failure to comply with the taxes in dealing with suspected criminals which it believes are infiltrating the legal alcohol industry. As noted on page 23, BATF was developing seven

hidden ownership/interest cases at the time of our review. We recognize BATF's opposition to the repeal of the taxes and believe the Congress should consider any effect repeal of the taxes might have on BATF's criminal enforcement efforts. The revenue foregone through repeal, however, need not necessarily enter into that consideration. If desired, it could be collected through another means and more efficiently by perhaps increasing the tax rates for other related excise taxes, such as the per-gallon tax on distilled spirits and wine and/or the per-barrel tax on beer.

If the Congress chooses not to repeal the alcohol occupational taxes, it may wish to consider legislation to improve compliance. BATF has drafted, and the Department of the Treasury and the Office of Management and Budget have approved, proposed legislation which would amend section 5111(a) and (b) of the Internal Revenue Code to restrict the sale of alcoholic beverages by wholesalers to those retailers who have paid their occupational taxes. According to BATF, the proposed legislation has been forwarded to the Congress but, as of April 17, 1986, it had not been introduced.

Agency Comments and Our Evaluation

The Director, BATF, in commenting on a draft of this report, essentially agreed with the basic concepts inherent in our recommendations and stated that BATF plans to address the problems by implementing a special tax collection program. (See app. VII.) BATF's program embodies our recommendation on the use of nonfederal data on newly licensed retail alcohol establishments but not our recommendation on matching occupational tax payments with other federal tax payment data. We agree that BATF has developed a viable program to enhance compliance and increase tax collections. However, as discussed below, we believe that our recommendation on data matching would enhance BATF's special tax collection program.

BATF initiated its special program in November 1985 but, to date, has made little progress. According to BATF, a hiring freeze has prevented it from obtaining key program resources, i.e., part-time "stay-in-school" employees who were to perform much of the work leading to the identification of potentially noncompliant taxpayers. BATF's information base for the program also relies extensively on state listings of licensees. State licensing data will be compared to federal listings of occupational taxpayers to identify potentially delinquent taxpayers. Our review showed that state alcohol licensing data is not always available or compatible for purposes of matching with federal tax data. First, 19 states

do not license all retail alcohol establishments at the state level. In addition, federal and state records do not always contain common identifying data. As a result, a number of potentially delinquent taxpayers identified through this match may have in fact paid the applicable tax. Such was the case for 47 percent of the taxpayers we identified as potentially delinquent through a similar match.

In view of BATF's resource constraints and the limits on the usefulness of state licensing data, including the prospect of dealing with local jurisdictions in 19 states to develop a complete data base, we believe our recommended match involving selected PIA codes would be an important component of BATF's compliance program. We recognize BATF's concern that a matching program using the two PIA codes PPSSCC recommended may be too restrictive and using all 16 codes that potentially identify retail alcohol establishments may be too costly in relation to the benefits realized. For these reasons we did not recommend how BATF should specifically implement the matching program. We would, however, consider a matching program involving the PIA codes for drinking places and liquor stores and directed only at the 19 states mentioned above as being superior and less costly than obtaining licensing data directly from the numerous local jurisdictions in these states.

The Wagering Occupational Taxes Could Be More Efficiently and Effectively Administered

IRS can improve the administration of the wagering occupational and related excise taxes by better utilizing information that it already requires or which is readily available without substantially increasing enforcement resources. We found compliance rates of about 84 and 81 percent for the tax on gross wagers in the two states reviewed. In addition to revenue lost through noncompliance, the monthly filing requirement for the tax on gross wagers unnecessarily adds to program costs.

Compliance With the Wagering Taxes

Some revenue is being lost through noncompliance with the tax on gross wagers in the two states where activities subject to the wagering taxes are authorized. We were unable, however, to devise a practical and projectable means for measuring compliance with the yearly occupational tax—whether the activities were authorized or unauthorized—or for the tax on gross wagers in states where the activities were unauthorized.

Compliance With the Tax on Gross Wagers

Every gambling business that conducts wagering subject to the taxes is required, on a monthly basis, to pay the tax on gross wagers. Compliance with the tax on gross wagers for authorized activities in Nevada and Washington was 84.4 and 80.8 percent, respectively. These states were the only states authorizing wagering subject to the taxes at the time of our review and which also maintained information on businesses licensed to conduct wagering activities.

We selected returns filed during two months of 1983 at the Ogden Service Center.[1] We compared these returns with the names of gambling licensees provided by the state gambling commissions to determine whether the federal wagering tax returns had been filed. The results of our study are shown in table 3.1.

Table 3.1: Compliance With Monthly Tax on Gross Wagers

State	State licensed wagering activities as of 3/31/83	Number sampled	State licensed wagering activities as of 12/31/83	Number sampled	Total sampled	Compliant	
						Number	Rate
Nevada	52	52	57	57	109	92	84.4
Washington	1,073	115	1,250	156	271	219	80.8

[1]Taxpayers from Nevada and Washington file returns with the Ogden Service Center.

During fiscal year 1983, the tax on gross wagers generated $6,423,342 in Nevada and $725,230 in Washington. We were unable to project the lost revenue associated with the nonfilers and potential underfilers from our compliance study because the taxes due are dependent upon the dollar amount of wagers received.

Compliance With the Yearly Occupational Tax

Every gambling business and every person accepting wagers on behalf of the business (e.g., employees/agents) are required to pay the yearly occupational tax. Although we could identify the businesses that should be paying the tax in the two states reviewed, information on employees/agents that should be paying was either unavailable or unreliable. We were therefore unable to devise a scientifically projectable sample to measure compliance because information was not available to determine who should be paying the tax.

We used the limited information that was available, however, to get an indication of compliance. We analyzed the returns of 80 businesses liable for the yearly occupational tax based on their filing of the tax on gross wagers for December 1983 at the Ogden Service Center. We determined that 69, or 86 percent, of the businesses, had paid their 1983 occupational tax.

The yearly occupational tax form requires employers to list the employees/agents accepting wagers on their behalf. We reviewed the 69 annual returns from businesses that paid the occupational tax to identify employee/agents who also should have paid the yearly occupational tax. Of the 69 business returns, 20 listed 116 employees/agents who accepted wagers on behalf of the business. We determined that 98 of the 116, or 85 percent, of the employees/agents had paid their yearly occupational taxes.

For the other 49 businesses, no information, not even a notation that there were no such employee/agents, was noted on the forms. Neither we nor IRS determined whether these 49 businesses had, but neglected to list, employees/agents who accepted wagers. According to Ogden Service Center officials, the apparent omission of this information is not a basis for rejecting the returns and followup contacts are not normally made. In commenting on a draft of this report, IRS said that the statement that the omission of this information is not a basis for followup with the filer is inconsistent with national office procedures as contained in the Internal Revenue Manual.

Because the information may be incomplete, and because the 69 business returns are not representative of all liable businesses, the results of the sample of 116 employees/agents are not necessarily representative of the total number of employees/agents liable for the tax.

Compliance With Wagering Taxes Could Be Improved

Compliance with the tax on gross wagers and the wagering occupational tax could be improved if IRS better utilized information it already requires and obtained information readily available to identify noncompliant taxpayers. IRS officials said the wagering taxes generate little revenue and therefore do not warrant extensive resources to promote compliance. We recognize IRS' concerns, yet we believe that compliance can be improved without labor-intensive measures.

Information is readily available from state gambling agencies to identify businesses liable for the yearly occupational tax and the tax on gross wagers but IRS is not using this information to identify delinquent taxpayers. To identify liable businesses in states which do not maintain such information, IRS could compare the yearly occupational tax payment records with the tax on gross wagers payment records. In addition IRS already has a means for identifying employees/agents liable for the yearly occupational tax because the returns filed by businesses (employers) require a listing of employee/agents accepting wagers on behalf of the business. However, based on our study, IRS does not enforce the requirement. Furthermore, when employers do list their employees, IRS does not use the information as a basis for determining whether the employees paid their taxes.

It appears that the majority of IRS' present wagering efforts are aimed a illegal activities. IRS audits of the wagering taxes resulted in $10.6 million in assessments in 1983. Of this amount, $163,000 of the assessment were made in Nevada and Washington—the two states where wagering, subject to the taxes, was authorized. In addition, IRS has conducted, or is conducting, five "wagering projects" which identify individuals liable for the wagering taxes who have not filed. None of the five projects are in the states of Nevada and Washington which have more readily available data on those liable for the taxes.

In the past, IRS obtained state gambling license information to identify potentially noncompliant taxpayers. Prior to the wagering tax rate reductions in 1982, the IRS Seattle District Office obtained state gamblin license information on establishments legally operating in the state of Washington and matched the licensees with IRS' tax payment data to

identify potentially delinquent taxpayers. According to IRS officials, the compliance program was discontinued because it was not cost-effective to send revenue agents to the potentially delinquent businesses after the tax was reduced for state authorized gambling activities, as of January 1, 1983, from 2 percent to 0.25 percent of gross wagers.

Using state licensee lists does not necessarily require sending revenue agents to the potentially delinquent businesses as the Seattle District did. We believe a more cost-effective alternative to verify and enforce tax compliance is to contact the businesses by letter or telephone, neither of which would necessarily require the use of revenue agents.

The other information that IRS could utilize to promote compliance is the information that is required on the businesses' (employers') occupational tax forms. IRS could review its tax payment records to determine if employees listed on the employers' forms had paid their occupational taxes. For those returns where there is no indication of whether or not employees/agents accept wagers, IRS could follow up to ensure that employers properly complete their wagering occupational tax returns.

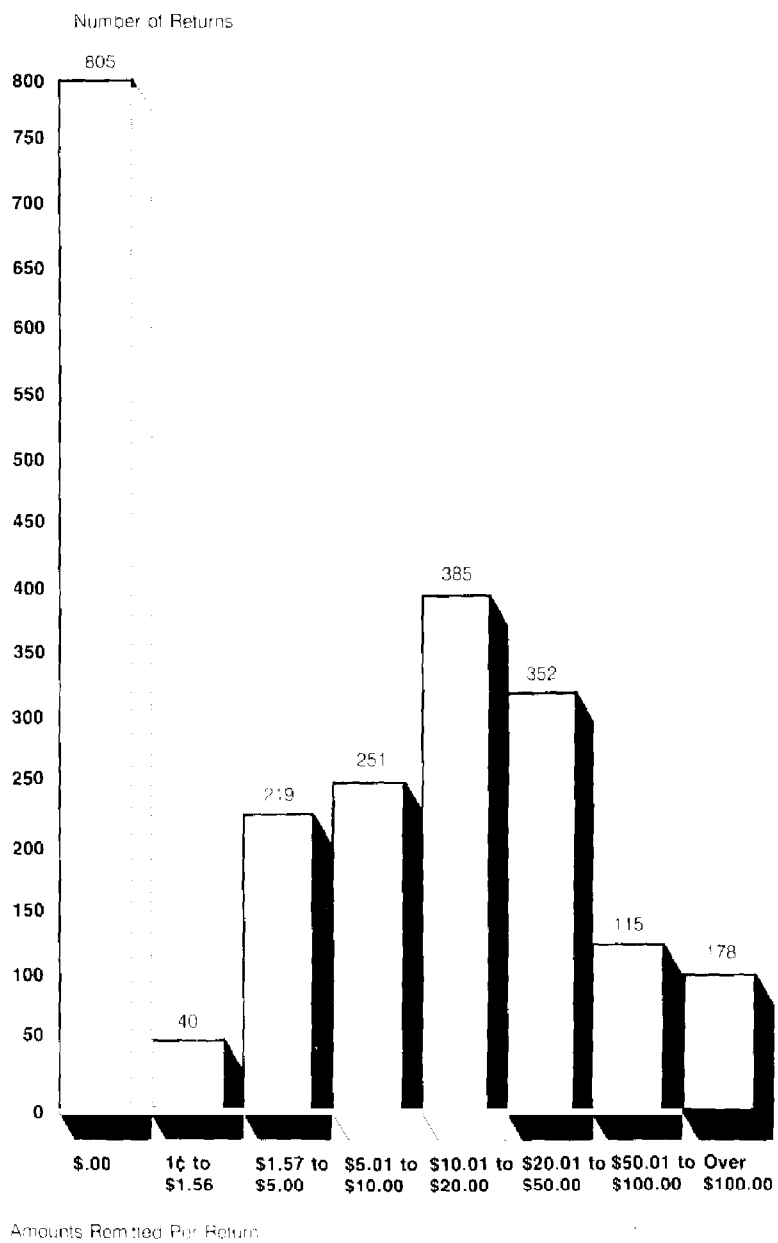
The Monthly Filing Requirement Results in Unnecessary Cost

The monthly filing requirement for the tax on gross wagers results in unnecessary costs. Because of this requirement, many returns are filed with little or no remittances. This filing requirement creates a burden on IRS as well as the taxpayer.

IRS regulations require that the tax on gross wagers be filed monthly, even if no tax is due. IRS told us that the expectation in 1951 when the tax was enacted was that the amount of taxes due would justify monthly filings. In passing the legislation, the Congress estimated the tax would yield $400 million in annual revenue. Since enactment, however, the annual tax collections have not exceeded $15.4 million.

We analyzed the tax on gross wagering returns filed with the Ogden Service Center for the months of March and December 1983. We also obtained IRS cost data to determine the cost of processing the returns. According to this data, the direct cost to process each return was $1.56. As shown in figure 3.1, 805, or 34 percent, of the 2,345 returns were filed with no remittances and an additional 40 returns contained $1.56 or less.

Figure 3.1: Profile of the 2,345 Tax on Wagers Returns Processed by the Ogden Service Center for March and December 1983



A majority of the other excise taxes are filed with the Form 720, "Quarterly Federal Excise Tax Return." This form is required to be filed quarterly unless the amount of tax due for a month exceeds $100 or the Service requires more frequent filing by a taxpayer who is not complying with the tax filing and payment provisions. If the tax on gross

wagers had the same dollar threshold filing requirement, 2,167 of the 2,345 returns reviewed, or 92 percent, would not have been required to be filed during the months of March and December 1983. Using IRS' direct cost of $1.56 to process each return, and assuming the two months reviewed are representative of the other 10 months, the estimated savings for the Ogden Service Center would have been $20,200. This estimate does not include IRS' indirect costs or the inconvenience and cost to taxpayers associated with filing returns with little or no tax remittances.

Wagering Taxes as a Criminal Law Enforcement Tool

In 1951, when the wagering taxes were enacted, the Congress chose to tax illegal activities, as well as legal activities, as a way to combat illegal bookmaking. The two criminal penalty provisions provided by the Congress were (1) willful failure to file a return, pay a tax, or retain transaction records which are punishable with up to 1 year in prison and/or a fine of up to $25,000 ($100,000 for corporations) and (2) willful attempt to evade or defeat the taxes which is punishable with up to 5 years in prison and/or a fine of up to $100,000 ($500,000 for corporations).

Because the focus of our review was on improving taxpayer compliance, we did not evaluate the effectiveness of the wagering taxes in combating unauthorized gambling. We did, however, review a number of cases developed by IRS' Criminal Investigation Division in Dallas so that the criminal law enforcement purposes served by the taxes would be considered in our assessment of IRS' tax administration compliance program. We reviewed the Dallas cases because that office develops more wagering tax cases than any other district. The results of the 37 cases closed by the Dallas IRS office during fiscal years 1981, 1982, and 1983 are presented in appendix V.

Conclusions

Because neither we nor IRS could determine the extent of illegal gambling activities subject to wagering taxes, we could not assess overall compliance. IRS could increase wagering tax compliance and revenue, however, by using information which is (1) already required but not always received and (2) not presently obtained but readily available to identify delinquent taxpayers.

The states we reviewed which authorize the gambling activities also maintain licensing data which could be obtained by IRS and compared against federal tax payment records to identify potential noncompliant

taxpayers. In addition, information to identify noncompliant occupational taxpayers is available from employers' occupational tax returns. Followup with potential noncompliant taxpayers could then be initiated with correspondence or telephone contacts.

We also believe that IRS can reduce the cost of administering the wagering taxes by modifying the monthly filing requirement to make it consistent with the other excise tax filing requirements. Modifying the requirement would also lessen the paperwork burden on taxpayers.

Agency Comments and Our Evaluation

The Commissioner of Internal Revenue, in commenting on a draft of this report (see app. VIII), expressed the belief that our proposals for increasing wagering tax compliance and revenues would not have a significant enough impact on either voluntary compliance or revenues to justify their implementation. Regarding our proposal for reducing the cost of administering the tax on gross wagers by modifying the monthly filing requirement, IRS believed that any savings would be negligible. IRS' compliance personnel were also concerned that a change would create taxpayer uncertainty, break established filing habits, and affect the Service's ability to identify trends, patterns, and nonfilers. IRS offered to review our proposal further if any additional information becomes available to verify cost savings or minimize compliance impact.

Proposals for Improving Compliance

IRS' detailed comments on our proposal for increasing compliance by state authorized wagering activities were based on its operations staffs' inference that we considered the compliance levels with the monthly tax on gross wagers generally high and the revenues relatively low in the two states reviewed. Given that inference, and in view of the need to allocate scarce resources to other areas of documented low compliance, IRS did not believe additional resources should be allocated to improving compliance. Because we did not intend to imply that compliance levels were relatively high, we followed up with IRS to further discuss its comments. An IRS official informed us that there was no disagreement with our findings nor did the Service disagree that our proposal, if implemented, would improve compliance with the wagering taxes. The Service did believe, however, that its limited resources would be more productively utilized in other areas.

Although IRS provided no documentation for its assertion that resources could be more productively used in other areas, we recognize that IRS does not have unlimited resources and agree in principle that resources

should be allocated on the basis of need. We believe, however, that our proposals could be implemented without a substantial resource commitment. We proposed that IRS obtain readily available licensing data from those states which authorize wagering subject to the taxes and use that data to identify potential nonfilers. Similarly, we believe that our proposal is in keeping with IRS' current plans to work more closely with the states. One of the initiatives in IRS' strategic operating plan is to develop additional sources of information to detect noncompliance through cooperative programs with the states. Beyond that, our proposals for improving compliance essentially involve IRS enforcement of an existing information reporting requirement and use of that information once it is obtained.

Given the above, we continue to believe our proposals have merit. Thus, to the extent that IRS, because of higher priority work, cannot take actions to improve compliance, it should so advise the Congress. The Congress could then, in light of the competing demands for limited government resources, either endorse IRS' management decision, provide the necessary resources for IRS to establish and maintain an appropriate presence, or consider repealing the taxes.

Proposal on Modifying the Monthly Filing Requirement

IRS disagreed with our proposal for modifying the monthly tax on gross wagers filing requirement. IRS believed the savings in processing costs would be negligible, the revision might generate more overhead costs than it would save in processing costs, and the change might adversely affect compliance.

We agree that our proposal would not result in substantial dollar savings to IRS but some savings would be realized. Although neither we nor IRS calculated the cost to change the filing requirement, we would anticipate that the cost of the change needed, i.e., revising the filing instructions, would not be significant. The form used for filing and the program for processing the forms when filed would remain essentially unchanged given that some taxpayers would continue to file monthly. And, while the cost to process each form may be slightly less ($0.09 based on IRS' revised estimate) than at the time we performed our analysis, IRS should not have to incur costs to process returns that include little or no tax remittances. Also, less frequent filing, as is the case with the majority of other excise taxes when the amount due is $100 or less, would reduce the cost and inconvenience to taxpayers.

IRS also stated its concern that a change in the filing requirement would adversely affect its compliance activities. Both during our review and after receiving IRS comments, we attempted but were unable to identify any compliance activities associated with the monthly filing requirement, or any adverse impact that would result from a change to quarterly filing. None of the wagering investigation cases provided for our review involved the monthly tax on gross wagers. At our request, IRS said it would develop information on the compliance benefits associated with monthly filing. Pending our analysis of further information, we believe that the monthly filing requirement should be revised.

Recommendations

To increase wagering tax revenue and taxpayer compliance, we recommend that the Commissioner of Internal Revenue:

- Obtain gambling license data from the states where gambling activities subject to the wagering taxes are authorized and match it with the yearly occupational tax payment records and the tax on gross wagers payment records to identify for followup potential noncompliant taxpayers.
- Compare tax on gross wagers payment records with the yearly occupational tax payment records for businesses in states which do not license establishments subject to the taxes to identify for followup potential noncompliant taxpayers.
- Match the names of employees/agents listed on the employers' occupational tax returns with occupational tax payment records to identify for followup potential noncompliant taxpayers. For the match to be effective, the requirement that employers list employees/agents on their occupational tax returns should be enforced.

To reduce costs of administering the tax on gross wagers, we also recommend that the Commissioner of Internal Revenue revise the filing requirement for the tax on gross wagers so that monthly returns will not be required unless an established dollar threshold is met.

Firearms Occupational Taxes: Overall Compliance Could Not Be Determined but a Reevaluation of Tax-Free Transfers May Be Needed

The National Firearms Act (NFA) tax on weapon transfers may not be realizing its full revenue potential. Of the 16,866 NFA weapons transferred during fiscal year 1984, 13,554, or about 80 percent, were transferred tax-free. Our analysis suggests that persons may be paying the dealer's annual occupational tax in order to avoid the tax on each weapon transferred and that the Congress may wish to consider whether the NFA tax-free transfer provision should be revised.

Another issue that arose during our review relates to former NFA dealers who continue to possess weapons acquired while they were dealers. In certain states, former NFA dealers may unknowingly be violating state laws which prohibit the private ownership of NFA weapons.

This chapter also discusses our attempts to measure overall compliance with each of the three types of NFA taxes—occupational, transfer, and making—and BATF's use of the NFA's penalty provisions to deal with the illegal possession of NFA weapons.

Compliance With the Firearms Taxes

Compliance with the NFA occupational taxes was 100 percent in the two states where compliance could be measured. Compliance with the NFA transfer and making taxes could not be measured because the population of liable taxpayers is unknown.

Compliance With the Occupational Taxes

Every NFA manufacturer, importer, and dealer operating in, and licensed by, the states of California and Louisiana had paid their NFA yearly occupational taxes of $500, $500, and $200 respectively for fiscal year 1984. We did not evaluate compliance in any other states because data were not readily available to identify who was liable for the tax.

To measure compliance with the NFA occupational taxes in the two states, we compared state records of NFA businesses with BATF's occupational tax payment records. This analysis included all of the 63 and 72 NFA businesses licensed by California and Louisiana, respectively. Our analysis was limited to these states because at the time of our review, they were the only states which required NFA businesses to obtain special state licenses. Several other states allow NFA business activities but do not issue special NFA licenses.

BATF attributes the 100 percent compliance rate with the yearly occupational taxes to the economic incentive of being recognized as NFA manufacturers, importers or dealers. NFA manufacturers are exempt from the

$200 per-weapon making tax provided they pay the yearly occupational tax. Likewise, importers are exempt from the $200 per-weapon tax on imported weapons provided they pay the yearly occupational tax. Also, each occupational taxpayer is exempt from the $200 per-weapon transfer tax when weapons are transferred between NFA occupational taxpayers.

Compliance With the Transfer and Making Taxes

The NFA transfer and making taxes are per-weapon taxes levied on those who transfer or make NFA weapons. The tax rate is $200 per weapon for machine guns, silencers, sawed-off shotguns, sawed-off rifles, and destructive devices. NFA weapons classified as "any other weapon" are taxed at $5 per weapon transferred—the making tax for "any other weapon" is $200. Per-weapon taxes must be paid and BATF approval must be obtained before individuals may legally make or transfer NFA weapons. NFA occupational taxpayers and persons conducting business exclusively with a federal, state, or local government agency may obtain BATF approval to make and transfer NFA weapons on a tax-exempt basis.

We were unable to measure overall compliance with the NFA transfer and making taxes. Neither we nor BATF could devise a way to readily identify the universe of individuals liable for the taxes. However, the number of NFA weapons registered and the number of cases developed by BATF involving the illegal possession of NFA weapons provides an indication of compliance and noncompliance respectively. (See apps. I and VI.) According to BATF officials, the volume of weapons made or transferred without BATF approval and tax payment is unknown, but they believe it is high.

Some Tax-Exempt Transfers Appear Questionable

Some persons may be using the tax-exempt transfer provision available to NFA dealers although they may not actually be engaged in the business as NFA weapons dealers. BATF Firearms Branch officials responsible for acting on tax-free transfer applications have long believed that some NFA dealers are not entitled to receive the transfer tax exemption but it is difficult to devise an effective means to remedy the situation. Our analysis of tax-free transfers by dealers in two states, although inconclusive, tends to support BATF officials' views. To the extent the exemption provision is being abused, the federal government is losing the revenue associated with the transfers.

Tax-exempt transfers between NFA occupational taxpayers are, by far, the most common method of acquiring NFA weapons. As shown in table

4.1, for fiscal years 1978 through 1984, the only years for which information is available, 75,328 NFA weapons were transferred tax-free between NFA occupational taxpayers. In comparison, during the same period, 20,756 weapons were transferred tax-paid.

Table 4.1: Comparison of Tax-Free and Tax-Paid Weapon Transfers

		Tax-free transfers		Tax-paid transfers	
Fiscal Year	Total transfers[a]	Number	Percent of total transfers	Number	Percent of total transfers
1978	10,660	8,822	82.8	1,838	17.2
1979	10,935	8,372	76.6	2,563	23.4
1980	12,390	9,025	72.8	3,365	27.2
1981	11,845	8,650	73.0	3,195	27.0
1982	14,299	10,874	76.0	3,425	24.0
1983	19,089	16,031	83.9	3,058	16.1
1984	16,866	13,554	80.0	3,312	20.0
Totals	**96,084**	**75,328**	**78.4%**	**20,756**	**21.6%**

[a]Excludes transfers to or between governmental entities, transfers of unserviceable firearms, transfers to heirs, and the interstate transfer of firearms for the purpose of repair.

BATF officials believe the same economic incentive which results in high compliance with the yearly dealer occupational tax also makes it attractive for individuals to obtain federal NFA dealer status.[1] For example, if an individual purchases more than one NFA weapon during the year, it would be economically advantageous to acquire dealer status and pay the $200 yearly occupational tax which permits tax-free transfers between occupational taxpayers. Otherwise, each weapon purchased would be subject to the $200 transfer tax.

BATF touched on this issue in responding, for the March 21, 1984, hearing record, to a question raised by the Senate Appropriations Committee. To the question, does restricting the possession of NFA weapons through tax laws present any unique problems, BATF said

"Because there is no requirement that a special (occupational) taxpayer dispose of the firearms accumulated under his license when he goes out of business, an individual can pay the $200 taxes required as a dealer, acquire as many firearms from other dealers as he wishes without paying the $200 per weapon transfer tax, then go out of business after having acquired a good collection of NFA firearms by paying only the one $200 fee for each year of business."

[1]To obtain NFA dealer status an individual must do two things. First, the individual must acquire a federal firearms license. By law, BATF must issue a license to any applicant who is an American citizen, 21 years of age or older, and who does not have a criminal record. Second, the individual must pay the dealer's occupational tax.

The extent to which such tax-free transfers are occurring is unknown. BATF Firearms Branch officials believe it is high and a significant amount of transfer tax revenue is being lost.

BATF Policy on Tax-Free Transfers

Under the NFA's transfer tax provision, all weapons transferred between NFA occupational taxpayers are exempt from the transfer tax. However, BATF's Ruling 76-22 restricts this exemption to NFA dealers "actually engaged in the business of selling NFA weapons." The ruling states:

"the mere possession of a license and a special (occupational) tax stamp as a dealer in firearms does not qualify a person to receive firearms transfer-tax-free. Any person holding a license and a special tax stamp as a dealer in firearms and not actually engaged within the United States in the business of selling NFA firearms may not lawfully receive NFA firearms without the transfer tax having been paid by the transferor. Where it is therefore, determined that the proposed transferee . . . is not actually engaged in the business of dealing in NFA firearms, such applications shall be denied. In addition, if such person receives NFA firearms without the transfer tax having been paid, such firearms may be subject to seizure for forfeiture as having been unlawfully transferred without payment of the transfer tax." [Emphasis added.]

BATF issued this ruling on October 15, 1976, in response to a perceived increase in the number of individuals acquiring NFA dealer status to acquire NFA weapons for their personal collections without paying the transfer tax. The 1974 BATF memorandum which led to BATF Ruling 76-22 states, in part:

"Obviously the exemption (from the transfer tax) provided for transfers between dealers was intended only for business purposes. However, the practice of becoming an NFA dealer to acquire firearms tax exempt for personal use has become very popular. It is taking place unchecked. . . ."

Although the ruling is clear in its intent, BATF officials told us that it is difficult to apply in practice. The operative phrase "actually engaged in the business" is not defined in the NFA act or BATF regulations. As to specific criteria for determining whether an NFA dealer is engaged in the business, BATF informed us that it has been guided by the courts. BATF added that the courts have stated that the phrase does not seem susceptible to a rigid definition but turns on the facts and circumstances of each case. As explained by BATF, to deny a tax-free transfer, the agency must determine the intent of the person at the time of the transfer of the weapon and establish that, at the time of the tax-free transfer, the person was not intending to engage in business as to that weapon.

Challenging the intent of the person at the time of the proposed transfer may be an extremely difficult task. This may account for the fact that within the last 5 years the ruling has not been used to deny a tax-free transfer.

GAO Analysis of Tax-Free Transfers

The exact number of persons who are acquiring NFA weapons tax-free as dealers but are "not actually engaged in the business" of selling NFA weapons cannot be readily measured. For the purpose of our analysis, however, we developed a criterion that would give us an indication of whether or not dealers were "actually engaged in the business." The criterion we used was whether NFA dealers acquired, but never sold, NFA weapons.

It is important to understand that this criterion is not intended to be definitive because the lack of sales does not necessarily mean that a dealer is not actually engaged in business. The dealer may have been unable to make a sale or may have gone out of business prior to making a sale for any number of reasons. On the other hand, just because a dealer sells an NFA weapon does not necessarily mean the dealer is engaged in the business. The sale may be just a weapons trade with another dealer. Despite these uncertainties, we believe the absence of any sales of NFA weapons is a useful indication of whether the tax exemption provision is being abused.

We analyzed a random sample of both current and former NFA dealers from the states of Florida and Illinois. Our analysis covered the selected dealers' activities from October 15, 1976, the date BATF Ruling 76-22 was issued, until July 28, 1984. As shown by table 4.2, 51 percent of the dealers sampled had acquired but, according to BATF records, had not sold NFA weapons.

Table 4.2: GAO Sample of NFA Dealers' Weapon Activities

	NFA dealers		Purchased but had not sold NFA weapons	
State	Total	Number sampled	Number	Percent
Florida	258	75	38	51
Illinois	89	39	20	51
Total	**347**	**114**	**58**	**51**

Based on the results of our sample, we project that between 149 and 203 of the 347 dealers in Florida and Illinois purchased but did not sell NFA weapons.

The 58 NFA dealers in Florida and Illinois who purchased but did not sell NFA weapons acquired 279, or 28 percent of the 983 weapons possessed by the NFA dealers reviewed. Our projection indicates that between 568 and 1,201 of the 3,130 weapons possessed by all NFA dealers in Florida and Illinois are possessed by dealers who did not sell any NFA weapons.

Of the 114 dealers included in our analysis, 38, or 33 percent, no longer had NFA dealer status at the time of our review. Also, as shown by table 4.3, 24 of the 38 former NFA dealers purchased but had not sold NFA weapons.

Table 4.3: Former NFA Dealers Sampled That Bought But Had Not Sold Weapons

	NFA dealers		No longer an NFA dealer		Purchased but had not sold NFA weapons	
State	Total in state	Number sampled	Number	Percent	Number	Percent
Florida	258	75	26	34.7	18	69
Illinois	89	39	12	30.8	6	50
Total	**347**	**114**	**38**	**33.3**	**24**	**63**

Projecting the results of our sample indicates that between 53 and 98 of the 347 dealers in the two states did not currently have NFA dealer status and purchased but had not sold any NFA weapons.

Former Firearms Dealers May Unknowingly Be Violating State Laws

BATF regulations allow NFA dealers, except for partnerships and corporations, to retain their NFA firearms inventories when they discontinue their status as NFA dealers. Partnerships and corporations must dispose of their firearms inventories in a manner acceptable to BATF because the weapons must be registered in the name of an individual if not part of a business inventory. In the case of a sole proprietorship that ceases to be an NFA dealer, the weapons are automatically registered to the owner without being subjected to the transfer tax.

Some former NFA dealers that operated as sole proprietorships and who retained, in an individual capacity, the weapons they acquired as dealers, may unknowingly be in violation of their state laws. The District of Columbia and nine states have laws which permit dealers, but not individuals, to possess one or all of the NFA type weapons. We wrote to these jurisdictions to determine what their laws provided with respect to former dealers who now possess weapons as individuals. Our inquiry was, of necessity, general in nature and did not identify the

dealers due to federal restrictions on the disclosure of taxpayer information.

All of the seven jurisdictions that responded told us that former dealers who continue to possess certain NFA weapons in an individual capacity either are or would appear to be in violation of their jurisdictions' laws. The jurisdictions we queried and their responses are shown in table 4.4.

Table 4.4: Nonfederal Jurisdictions' Responses on NFA Weapons Possessed by Individuals

Jurisdiction	Violates state law	Appears to violate state law	No response
California	x		
District of Columbia		x	
Illinois		x	
Iowa			x
Kansas	x		
Michigan		x	
Missouri		x	
Nevada	x		
North Carolina			x
Rhode Island			x

One of these states, Illinois, was included in our two-state (Florida and Illinois) analysis of tax-free NFA weapon transfers. On the basis of our analysis, 12 of the 39 former Illinois NFA dealers sampled appear to be violating state law because, according to BATF's records, they currently possess NFA weapons as private citizens.

The National Firearms Act as a Criminal Law Enforcement Tool

BATF believes the single most important feature of the NFA is its ability to serve broader law enforcement objectives through the tax code. According to BATF officials, the penalties available for failure to comply with the tax code provisions provide a means for effectively dealing with individuals involved in crime. Penalties for failure to comply with the NFA can result in sentences of up to 10 years in prison and/or fines of up to $10,000. Offenses include the illegal manufacture, importation, possession, or sale of NFA weapons.

The importance BATF places on the penalties for failure to comply with the NFA is illustrated by the BATF Director's testimony before the House Judiciary Committee, Subcommittee on Crime, on May 24, 1984. In testifying on the value of the NFA to combat illegal drug dealers, he stated:

"Drug smugglers and dealers seem to embrace machine guns as their weapons of preference. Ironically, the sense of security and protection from rivals, which these criminals seem to derive from NFA weapons, is often their Achilles Heel. Just as Al Capone fell victim to tax violations rather than bootlegging charges, today's drug trafficker often falls victim to weapons charges when narcotics violations prove more difficult or impossible to establish."

BATF's Law Enforcement Division uses the NFA to assist other federal, state, and local law enforcement agencies in the fight against crime and criminal organizations. This is done in conjunction with the agency's Crime Impact Program (CIP). Under the CIP, each of BATF's 22 Law Enforcement District Offices defines the crime problems in its geographic area by interaction with local authorities. After the crime problem has been defined, BATF then targets its resources on the crimes and criminal organizations most susceptible to federal enforcement efforts.

Because the focus of our review was on improving taxpayer compliance, we did not evaluate the effectiveness of the CIP, a program that is primarily oriented toward combating crime rather than increasing compliance with tax laws. We did, however, review a number of cases developed by BATF for failure to comply with the NFA so we could better understand how BATF uses the NFA to combat crime and consider that in our evaluation of tax administration matters. At the suggestion of BATF, we reviewed cases in two districts—Chicago and Miami. According to BATF, cases developed in these two districts illustrate the usefulness of the NFA in combating crime. Summary statistics of the 58 cases we reviewed are provided in appendix VI.

Conclusions

Data is not readily available to identify the universe of businesses and individuals liable for the NFA occupational and related excise taxes. We were therefore unable to draw an overall conclusion as to taxpayer compliance. In the two states which require businesses to obtain NFA type state licenses, we were able to determine that the state licensed businesses had paid their federal occupational taxes. BATF asserted, and we agree, that the 100 percent compliance noted in the two states reviewed can be attributed to the economic incentive that exists for paying the annual $200 NFA occupational tax rather than a separate $200 tax on each weapon transferred.

The economic incentive which promotes NFA dealer compliance with the annual occupational tax also gives rise to the potential for tax avoidance. Because NFA weapons may be transferred, tax-free, between occupational taxpayers, there is an incentive for persons to acquire NFA dealer status even though they are not actually engaged in the business of dealing in NFA weapons. Although BATF officials believe that such tax avoidance is occurring, it is difficult for them to challenge whether proposed weapons transfers are bonafide business transactions. Accordingly, we present alternative actions that the Congress may wish to consider should it desire to reduce the potential for individuals to avoid the per weapon transfer tax.

Another issue relates to former NFA dealers who may unknowingly be in violation of the laws of their jurisdictions when they retain, as private citizens, the weapons they acquired as NFA dealers. Some states and the District of Columbia prohibit the possession of certain NFA weapons by private citizens. We believe BATF should inform former NFA dealers that they may be in violation of their jurisdictions' laws by virtue of their continued possession of NFA weapons. We also believe that BATF, in its publications or correspondence, should provide current and prospective NFA dealers with a similar notification prior to or upon termination of their status as NFA dealers.

Recommendations

We recommend that the Director, BATF,

- inform former NFA dealers who currently possess NFA weapons that such possession may be in violation of the laws of their respective jurisdictions and
- develop a means for informing current NFA dealers and those that apply for NFA dealer status that, should they discontinue their status as NFA dealers, the retention of NFA weapons as a private citizen may be a violation of the laws of their respective jurisdictions.

Agency Comments and Our Evaluation

BATF agreed to inform current and future dealers that, should they cease to be dealers and still possess NFA weapons, they should be aware that some state and/or local jurisdictions forbid private ownership of NFA weapons. BATF said, however, that the process of determining which former dealers resided in jurisdictions that prohibited private ownership of NFA weapons and then mailing some form of notification to such persons would place a considerable administrative burden on the Bureau. We agree that it could be a burden for BATF to identify and individually

contact all former dealers that may be in violation of their jurisdictions' laws. Although individual identification and contact may represent a preferred method of notification, we did not intend for BATF to consider it as the only method that would accomplish the objective of our recommendation. We would consider other methods, although less direct and perhaps not as comprehensive, as being responsive to our recommendation. For example, BATF could make a public service announcement in trade publications on the assumption that former dealers continue to read such publications.

Matter for Consideration by the Congress

An incentive exists for individuals to obtain NFA dealer status to avoid the per weapon transfer tax. Whether and, if so, how the incentive should be reduced or eliminated is a policy issue the Congress may wish to address. We identified and assessed four alternatives for the Congress to consider should it wish to legislatively address the issue. Further, the first alternative would also eliminate the potential for individuals to become in violation of their jurisdictions' laws by virtue of their continued possession of weapons they acquired as dealers.

BATF has also been concerned that individuals become NFA dealers to build their own firearms collections while avoiding the per weapon transfer tax. BATF developed three legislative proposals that it believes will eliminate the problem. (See app. VII.) BATF's proposal for amending the definition of "transfer" closely parallels the first of our alternatives discussed below.

Require Disposition of Weapons Acquired Tax-Free

The NFA could be amended to require persons who are no longer NFA dealers to dispose of all NFA weapons that were acquired tax-free. The disposition of weapons could be guided by the existing provisions of the NFA and BATF regulations. That is, the weapons could be re-registered to the former NFA dealer as a private citizen; sold to other dealers, government entities, or private citizens; or abandoned to BATF.

This alternative has two primary advantages. It could increase federal revenues and it would not be difficult to implement. For weapons disposed of after expiration of dealer status, revenue would be generated by tax-paid transfers to private citizens, other dealers, or re-registration to the former NFA dealers. In terms of implementation, BATF need only notify dealers who did not retain their NFA status for the current year and process the paperwork necessary to effect the weapons transfers.

On the other hand, this alternative has two disadvantages. First, the tax would be assessed on all former dealers regardless of their prior dealer activities. A former dealer who bought and sold NFA weapons would be required to dispose of his or her weapons in the same manner as a former dealer which bought but never sold NFA weapons. This would penalize dealers who were actually engaged in the NFA weapons business as well as those who were not.

Second, this alternative would change the way sole proprietorship NFA dealers are presently treated. BATF regulations currently provide that when a sole proprietorship ceases to be an NFA dealer, the weapons automatically are registered to the owner without being taxed. This alternative would result in a tax burden on individuals similar to that of former NFA dealers that operated as corporations and partnerships. When either of these latter forms of business cease to be dealers, all NFA weapons in their inventories must be re-registered to an individual or otherwise disposed of along with payment of the applicable tax.

Establish Criteria for Determining Whether Dealers Are Actually Engaged in the Business

It is currently very difficult for BATF to determine whether proposed weapons transfers between occupational taxpayers are bonafide business transactions for which the tax exemption is available. Congressionally established criteria for determining whether dealers are "actually engaged in the business" would define, for both BATF and NFA dealers, the business activities the Congress believes justify tax exemptions.

We recognize the difficulty associated with defining what constitutes being actually engaged in the business. Indeed, establishing at the time of a proposed weapon transfer that the NFA dealers involved are not engaged in business as to that weapon may be nearly impossible. Accordingly, it may be more practical to develop criteria that would be applied subsequent to the actual weapon transfer. For example, a criterion might be that the transferee must realize a profit on the sale of NFA weapons within a specified period of time in order for weapons to retain the tax-free transfer exemption. To the extent that criteria can be developed, BATF would have the tools it believes are needed to ensure that only weapons transferred for business purposes are transferred tax-free. Also, federal revenues could increase as weapons transfers that would otherwise be made tax-free would, under established criteria, be classified as non-business in nature and therefore subject to the per-weapon tax.

A potential disadvantage of this alternative is the increased paperwork burden on taxpayers and BATF. Depending on the nature of the criteria established, BATF might need to require NFA dealers to submit documentation showing they meet the established criteria. This additional paperwork might in turn increase BATF's cost in time and resources to review and act on proposed weapons transfers.

Repeal the Tax Exemption for Transfers Between Occupational Taxpayers

Another approach to eliminating the opportunity that exists for tax avoidance is the repeal of the provision allowing tax-free weapon transfers between occupational taxpayers. This alternative would serve to increase federal revenues to the extent that approved weapons transfers continue and become subject to the per-weapon tax. For example, if the transfers between occupational taxpayers during fiscal year 1983 had not been exempt from the per-weapon tax, $3.2 million would have been generated. The gain in the per weapon transfer tax revenue would be offset somewhat, however, because fewer individuals may be likely to obtain NFA dealer status and pay the annual occupational tax in the absence of a tax exemption on each weapon transfer.

Repeal of the transfer tax exemption would also have other ramifications which, depending on one's view, would be positive or negative. Assuming the transfer tax would be reflected in the selling price of each weapon, the cost to the ultimate customer would increase. For example, an NFA weapon could be taxed, and the selling price presumably increased, three times as it is transferred between the manufacturer, wholesaler, retailer, and customer. We did not evaluate what effect increased costs would have on the sale of NFA weapons.

Increase the Annual Occupational Tax

The incentive to obtain NFA dealer status in order to avoid the transfer tax on NFA weapons could be reduced or eliminated by increasing the annual $200 occupational tax. The degree to which the incentive would be reduced or eliminated would depend on the amount of the tax increase. According to BATF, a December 1983 estimate by the Bureau of Labor Statistics indicates that inflation alone would serve to raise the $200 tax, set in 1934, to $1,500. Using the $1,500 amount for purposes of illustration, an individual would have an incentive to obtain dealer status only if eight or more weapons transactions were anticipated during the year.

An increase in the annual occupational tax could be viewed as unfair by NFA dealers who consider themselves to be actually engaged in the business and could in turn have an effect on the number of businesses that become or continue as dealers in NFA weapons. Also, the cost of NFA weapons to the ultimate customer would increase, assuming that the tax increase was reflected in the selling price of NFA weapons.

Number and Type of National Firearms Act Weapons Registered as of May 10, 1984

Table I.1

Type of weapon	Registrations	
	Number	Percent of total
Machine guns	101,361	52.0
Silencers	12,801	6.5
Sawed-off rifles	11,399	5.8
Sawed-off shotguns	21,443	11.0
Destructive devices	15,166	7.7
Any other weapon	31,217	16.0
Weapons not classifiable	1,553	0.7
Total registrations	**194,940[a]**	**99.7[b]**

[a]52,667 weapons (27 percent) were registered during a one-month amnesty period in November 1968.

[b]Amounts do not total to 100 percent due to rounding.

National Firearms Act Registrations by Type and by State as of May 10, 1984 (Listed in Order of Weapons Registered)

	State	Machine guns	Silencers	Sawed-off rifles	Sawed-off shotguns	Destructive devices	Any other weapon	Weapons not classifiable	Total all types	Percent of total
1.	TX	10310	2278	1059	2127	267	2461	140	18642	9.6
2.	CA	6817	311	838	2314	3621	3093	106	17100	8.8
3.	FL	6421	1815	252	825	220	1105	24	10662	5.5
4.	OH	5311	832	518	689	393	1203	63	9009	4.6
5.	AZ	3234	495	489	368	3490	465	41	8582	4.4
6.	PA	4699	256	583	565	610	1002	81	7796	4.0
7.	GA	4068	1164	301	869	91	850	50	7393	3.8
8.	IL	3643	148	343	990	1130	827	49	7130	3.7
9.	VA	2759	288	312	440	585	888	38	5310	2.7
10.	MI	2773	103	341	522	254	1074	59	5126	2.6
11.	NY	3391	44	201	277	189	741	49	4892	2.5
12.	OK	2460	423	292	673	54	775	33	4710	2.4
13.	AL	2183	328	348	760	96	794	16	4525	2.3
14.	IN	2511	561	183	440	160	599	34	4488	2.3
15.	TN	2302	285	193	591	227	605	30	4233	2.2
16.	OR	1532	209	504	464	80	1139	48	3976	2.0
17.	MA	2747	30	241	221	135	535	35	3944	2.0
18.	CT	2756	244	184	153	230	300	26	3893	2.0
19.	MO	1511	86	277	824	133	943	61	3835	2.0
20.	WA	889	33	318	398	946	1131	30	3745	1.9
21.	KY	2186	204	191	487	163	459	22	3712	1.9
22.	MD	2445	294	196	169	137	401	20	3662	1.9
23.	NJ	2336	28	133	294	172	440	32	3435	1.8
24.	LA	1859	365	160	371	96	381	17	3249	1.7
25.	CO	1549	310	214	341	60	694	27	3195	1.6
26.	NC	1602	258	209	494	94	462	24	3143	1.6
27.	WI	1856	176	171	275	101	528	15	3122	1.6
28.	MN	723	9	189	592	55	994	67	2629	1.3
29.	UT	1329	202	71	102	430	161	3	2298	1.2
30.	IA	748	33	160	460	55	796	34	2286	1.2
31.	KS	880	31	174	370	37	605	26	2123	1.1
32.	SC	795	24	199	517	61	493	28	2117	1.1
33.	AR	1070	115	121	325	44	351	31	2057	1.1
34.	MS	1246	14	96	341	33	226	10	1966	1.0
35.	NE	700	58	151	305	33	595	25	1867	1.0
36.	NM	1003	166	148	139	19	165	14	1654	0.8
37.	NV	1003	165	71	124	31	204	10	1608	0.8

State	Machine guns	Silencers	Sawed-off rifles	Sawed-off shotguns	Destructive devices	Any other weapon	Weapons not classifiable	Total all types	Percent of total
38. WV	819	41	154	173	28	280	10	1505	0.8
39. ME	440	7	126	156	36	479	17	1261	0.6
40. ID	490	57	107	156	9	368	13	1200	0.6
41. MT	581	29	102	143	25	309	11	1200	0.6
42. DC	647	17	33	19	359	90	3	1168	0.6
43. AK	644	112	42	62	13	208	2	1083	0.5
44. WY	488	79	79	130	27	245	22	1070	0.5
45. NH	438	27	76	59	63	197	18	878	0.5
46. SD	297	22	59	123	9	297	18	825	0.4
47. ND	194	4	55	105	14	115	5	492	0.2
48. RI	236	4	26	26	12	41	8	353	0.2
49. VT	155	7	42	27	17	53	4	305	0.2
50. HI	206	2	38	11	10	23	3	293	0.2

Sampling Methodologies for the Alcohol, Wagering, and Firearms Tax Studies

Alcohol Occupational Tax Studies

We conducted three compliance studies in the alcohol occupational tax area: (1) retail dealers, (2) wholesale distributors, and (3) brewers. Each of the three alcohol occupational tax studies was designed to determine the compliance rates for the occupational taxes covering the period July 1, 1983, to June 30, 1984.

Retail Compliance Study

The retail dealers compliance study had four parts: we (1) randomly selected the retail dealers to review, (2) had IRS review its records to verify proof of payment, (3) referred sampled cases to BATF for compliance determination when IRS' records did not indicate taxpayer compliance, and (4) verified, on a sample basis, the information provided by BATF.

To select the retail dealers from three of the four states included in our review, we performed five steps. First, communities within the states were placed into one of the following categories:

Stratum 1 - communities with populations under 25,000;

Stratum 2 - communities with populations from 25,000 to 99,999;

Stratum 3 - communities with populations from 100,000 to 249,999;

Stratum 4 - communities with populations of 250,000 and above.

This stratification was done to insure that communities with larger populations had a higher probability of being selected for review. 1980 Bureau of Census data was used to categorize the communities into the above stratas.

Second, we identified each community's Zip Code(s) using the 1983 National Zip Code Directory. Then, we randomly selected Zip Codes from each of the four population stratas. Next, we identified all the retail dealers operating within the sampled Zip Codes using liquor license data provided by the state alcohol agencies for the states reviewed. Our final step was to randomly select a sample of the retail dealers.

For Florida, we sampled by community rather than by Zip Code because the Florida alcohol licensing data base did not contain Zip Codes for the establishments. As a result, the Florida sample was proportionally larger than the other sampled states.

After selecting the retail dealers to sample, we requested IRS to review its tax payment records to determine if the retail establishments had paid their taxes. IRS made this check using ownership information from the state liquor licenses.

Retailers for whom IRS had no record of tax payment were referred to BATF for a compliance determination. BATF agents made the compliance determination by contacting the establishments through correspondence, telephone calls, and/or site visits.

Our final step was to verify, on a sample basis, the reliability of the compliance information provided by BATF. We were able to verify, on a sample basis, the accuracy of all the establishments reported by BATF as compliant. We were able to verify, on a sample basis, the accuracy of 82.4 percent, or 56 of the 68 cases, reported by BATF as noncompliant. We could not verify noncompliance for 11 of the remaining 12 cases because the taxpayers' employer identification numbers were either missing or apparently incorrect. Employer identification numbers are required to access IRS' taxpayer occupational tax payment data. For the other case, IRS' tax payment record indicated the retailer had paid the tax.

The confidence level for the retail dealer compliance study was 95 percent. The standard error rate was 6.5 percent.

The detailed results of our sample, by stratum, are shown in Table III.1. The percentage of compliant and delinquent retailers are weighted projections based on the number of licensed establishments operating in each stratum.

Table III.1: Retail Alcohol Occupational Excise Tax Compliance Study

State/population	Retail dealers	Zip codes: In each population category	Zip codes: Selected for sampling	Retail dealers: Operating in zip code areas sampled	Retail dealers: Randomly Sampled	Retail dealers: Delinquent	
California:	58,040						
under 25,000		1,094	10	236	84	34	
25,000- 99,999		292	4	163	37	24	
100,000-249,999		181	3	88	33	15	
250,000 and above		291	4	199	48	21	
Subtotal		**1,858**	**21**	**686**	**202**	**94**	**(46.3%)**
Florida[a]	27,583						
under 25,000		645	10	350	82	27	
25,000- 99,999		51	5	245	64	21	
100,000-249,999		5	3	886	83	26	
250,000 and above		3	3	2,378	112	29	
Subtotal		**704**	**21**	**3,859**	**341**	**103**	**(28.4%)**
Illinois:	21,869						
under 25,000		1,247	11	78	50	6	
25,000- 99,999		104	4	242	46	9	
100,000-249,999		34	3	82	26	8	
250,000 and above		63	3	551	66	35	
Subtotal		**1,448**	**21**	**953**	**188**	**58**	**(38.7%)**
Texas:	43,639						
under 25,000		1,498	12	156	72	36	
25,000- 99,999		99	3	344	54	16	
100,000-249,999		101	3	234	43	23	
250,000 and above		364	4	210	43	14	
Subtotal		**2,062**	**22**	**944**	**212**	**89**	**(39.1%)**
Total	**151,131**				**943**	**344**	**(39.9%)**

[a]Zip code data for Florida licensees was not available; therefore, the sample was by community. Also, we inadvertently omitted fraternal organization permits and one type of off-sale permit from our compliance study in Florida. As a result, the combined compliance rate does not include the 1,058 fraternal organizations and 539 off-sale establishments licensed to operate in Florida at the time of our review.

Wholesale Compliance Study

The wholesale dealers compliance study consisted of three parts: We (1) randomly selected the wholesalers to review; (2) had IRS review its records for proof of payment; and (3) referred sampled cases to BATF for followup when IRS' records did not indicate taxpayer compliance.

We randomly selected the wholesale dealers for review from licensing data provided by the alcohol agencies in the four states included in the review.

Using the ownership identification data listed in the states' liquor license data bases, we had IRS review its tax payment records to determine taxpayer compliance. Those wholesalers for which IRS' records did not show tax payment were referred to BATF for compliance determination.

The confidence level for our wholesale compliance study was 95 percent. The standard error rate was 7 percent.

Brewers Compliance Study

From states' licensing data, we identified 13 brewers that were operating in the four sample states. We determined compliance for all 13 brewers by having IRS review its tax records for proof of payment. IRS had proof of payment for each of the 13 brewers.

Wagering Tax Studies

We reviewed compliance with the tax on gross wagers and the yearly wagering occupational tax. We also developed information on investigations conducted for illegal wagering activities.

Tax on Gross Wagers Study

Measuring compliance with the tax on gross wagers was a two-step process. First, we randomly selected for review 271 of the 1,250 state licensed gambling establishments operating in Washington and all 57 of the licensed gambling establishments in Nevada. Next, we reviewed IRS' tax payment records for the months of March and December 1983 to determine whether the sampled establishments had filed the monthly tax on gross wagers returns.

The above process allowed us to determine what percentage of liable taxpayers had filed a return. However, because the tax liability is based on the gross wagering revenue received and we had no means to determine the actual amount of gross wagers accepted by businesses that did or did not file returns, we were unable to project the lost revenue through noncompliance.

The confidence level for this study was 95 percent. The error rate was 4 percent for Washington and 3.7 percent for Nevada.

Yearly Wagering Occupational Tax

We were unable to devise a scientifically projectable sample for measuring compliance with the yearly wagering occupational tax. We did use the information that was available to get an indication of compliance. We determined whether businesses that filed the monthly tax on gross wagers returns had also paid their annual occupational taxes, but there is no basis to consider the results as being representative of the universe of those liable for paying the tax.

Wagering Tax Criminal Violations Study

To obtain a better understanding of how IRS uses the wagering tax provisions as a law enforcement tool, we reviewed tax cases worked by IRS' Criminal Investigation Division at the Dallas Office. We reviewed all of the 37 investigations closed by the office during fiscal years 1981, 1982, and 1983. In addition, we reviewed summary statistics of the nine Grand Jury wagering tax cases developed by the Dallas office during fiscal year 1983.

NFA Studies

We conducted three studies in the NFA area. The first study measured the compliance rates for the NFA occupational taxes. The second study analyzed a sample of tax-free NFA weapons transfers. The third study analyzed investigations BATF conducted for NFA violations.

NFA Occupational Tax Study

Measuring compliance with the NFA occupational taxes was a three-step process. First, we obtained from the states of California and Louisiana listings of licensed NFA dealers. Our analysis was limited to these states because, at the time of our review, they were the only states that required NFA businesses to obtain special licenses to engage in NFA business activities. Next, we compared the state listings of all licensees with BATF's records of occupational tax payments covering the period July 1, 1983, to June 30, 1984. Finally, all discrepancies were resolved either through contact with BATF's Dallas and San Francisco Regional Offices or its Headquarters NFA Branch located in Washington, D.C.

NFA Tax-Free Weapons Transfers

We analyzed the tax-free NFA weapons transfers by dealers in two states (Florida and Illinois) to determine: (1) the number of years the dealers had paid the occupational tax, (2) the number of NFA weapons the dealers acquired and sold, and (3) the number of weapons still possessed by former NFA dealers.

We obtained from BATF's NFA Branch listings of Florida and Illinois dealers who acquired weapons through tax-free transfers between 1976 and 1984. Using these listings, we randomly selected the dealers for review. After selecting our sample population, we reviewed the records maintained by BATF's NFA Branch regarding the weapons acquired and transferred by NFA dealers.

The confidence level of our NFA dealers tax-free transfer study was 95 percent. The error rate was 10 percent. Because our study was limited to the two states, it is not necessarily representative of the dealer activities in the other states.

NFA Criminal Violations Study

To obtain a better understanding of how BATF uses the NFA as a law enforcement tool, we reviewed a sample of investigative case files at BATF's Chicago and Miami District Offices. Our sample was selected from NFA cases closed and forwarded to the U.S. Attorneys during fiscal years 1981, 1982, and 1983. We randomly selected and reviewed 26 of the 30 Chicago cases and 32 of the 116 Miami cases.

From the case files we obtained information on defendants' prior criminal records, the investigative results, NFA weapons involved, and items seized as a result of the investigations.

As we did not attempt to project the results of these studies, we did not establish a confidence level or error rate.

Principal Industry Activity Codes for Establishments Which May Be Selling Alcoholic Beverages

Codes		Description
1.	5813[a]	Drinking places
2.	5921[a]	Liquor stores
3.	5411	Grocery stores
4.	5451	Dairy products stores
5.	5490	Other food stores
6.	5541	Gasoline service stations
7.	5812	Eating places
8.	5912	Drug and proprietary stores
9.	5999	Miscellaneous retail stores
10.	7012	Hotels
11.	7013	Motels, motor hotels and tourist courts
12.	7032	Sporting and recreational camps
13.	7932	Billiard and pool establishments
14.	7933	Bowling alleys
15.	7948	Racing, including track operations
16.	7980	Other amusement and recreation services

[a]These codes are listed out of numerical sequence because, of all the codes, they possess the highest potential for being associated with establishments that would sell alcoholic beverages.

Dallas IRS Criminal Investigation Division Closed Wagering Cases During Fiscal Years 1981, 1982 and 1983

Number Of Investigations	37	
Number Of Suspects	53	
Convictions:		
Misdemeanor Violations	26	
Felony Violations	0	26
Penalties:		
Incarceration	5	
Probation	2	
Fine	19	26
Profile Of Suspects:		
Prior Bookmaking Arrest(s)	8	
Prior Arrests (other offenses)	14	
No Prior Arrests	8	
Unknown	23	53

Note: Includes cases (1) forwarded to the U.S. Attorney for prosecution (27 cases), and (2) terminated by the Dallas Criminal Investigation Division but not forwarded to the U.S. Attorney (10 cases).

Summary Statistics for the National Firearms Act Criminal Investigative Cases Reviewed

Table VI.1: Cases Developed by BATF and Reviewed by GAO

BATF District	Cases Developed[a] 1981-1983	Cases Reviewed
Chicago	30	26
Miami	116	32
Total	**146**	**58**

[a]Includes only those cases forwarded to U.S. Attorneys for prosecution.

Table VI.2: Origin of Investigations

	Chicago District	Miami District	Total
BATF initiated	7	12	19
Referred by other agency:			
State or local police	3	3	6
Other federal agency	2	5	7
Joint investigation:			
State or local police	7	5	12
Other federal agency	5	5	10
Federal and state task force	2	2	4
Total	**26**	**32**	**58**

Table VI.3: Results of NFA Investigations

	Miami	Chicago	Total
Cases reviewed	32	26	58
Defendants:			
With prior arrest records	30	22	52
Without prior arrest records	40	6	46
Arrest records, if any, not documented	3	4	7
Total defendants	**73**	**32**	**105**
Judicial results:			
NFA convictions	40	12	52
Other federal convictions			
Conspiracy	2	2	4
Dealing in firearms without a license	1	1	2
Possession/distribution of narcotics	10	•	10
Felon possessing a firearm	2	•	2
State convictions			
Possession/distribution of narcotics	2	•	2
Illegal possession of firearms	2	2	4
Other	•	1	1
Total convictions	**59**	**18**	**77**
NFA violations	4	8	12
Other federal violations	•	•	•
State violations	1	•	1
Total	**5**	**8**	**13**
Pending prosecution/not yet indicted	15	6	21
Sentences:			
For federal convictions			
Prison	36	3	39
Probation and/or fine	15	12	27
Not yet sentenced	4	•	4
For state convictions			
Prison	2	1	3
Probations and/or fine	1	2	3
Not yet sentenced	1	•	1
Total sentences	**59**	**18**	**77**

Table VI.4: Type and Volume of Illegally Possessed NFA Weapons

NFA weapon involved in case	Chicago	Miami	Total
Machine guns:			
Illegally converted semi-automatics	16	60	76
Manufactured machine guns	2	1	3
Silencers:			
Made from commercially sold kits	4	22	26
Homemade	4	123	127
Origin unknown	2	15	17
Sawed-off shotguns	19	14	33
Sawed-off rifles	1	3	4
Destructive devices	3	13	16
Any other weapon	1	1	2
Total	**52**	**252**	**304**

Table VI.5: Items Other Than NFA Weapons Coming Into BATF Custody

	Number of items seized by		
Description	**Chicago District**	**Miami District**	**Total**
Handguns	56	165	221
Shotguns and rifles	37	85	122
Other (unidentified) firearms	•	110	110
Illegal narcotics			
Cocaine (lbs.)	•	7.2	7.2
Marijuana (lbs.)	•	2,058	2,058
Other	•	(30,000 quaaludes) (22 lbs. hashish)	(30,000 quaaludes) (22 lbs. hashish)
Miscellaneous items			
Vehicles	1	12	13
Cash	•	$165,400	$165,400

Advance Comments From the Director, Bureau of Alcohol, Tobacco and Firearms

OFFICE OF THE DIRECTOR

DEPARTMENT OF THE TREASURY
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS
WASHINGTON, D.C. 20226

FEB 5 1986

I:A:JNB

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

Thank you for the opportunity to comment on your draft report entitled, "Tax Administration: Occupational and Related Excise Taxes." We find the report to be thorough, well-presented, well-documented and the individual issues discussed are treated fairly. We have no objections to the recommendations as they are presented. We have included, however, some suggestions of our own that would still attain the concepts inherent in your proposals.

We hope these comments will be helpful in preparing your final response.

With kind regards.

Sincerely yours,

Stephen E. Higgins
Director

Enclosure

BATF COMMENTS

GAO REPORT

SPECIAL TAXES

A. ALCOHOL SPECIAL OCCUPATIONAL TAXES

1. Recommendations for BATF Action

We are in agreement with the two basic premises that the ultimate solution to attaining a satisfactory compliance level lies in increased resources and that there are inherent difficulties in enforcing special tax requirements. We agree too with the contention that some revenue is being lost because of retailer non compliance with special tax provisions.

Your suggestion that, barring any staffing increases, BATF should consider other low labor intensive approaches to increase compliance is well taken. You make two specific recommendations to accomplish that end.

In regard to your first recommendation we note it is similar to the suggestion made by the PPSSCC in their report. We explored their suggestion at the time that report was issued. We found the suggestion to be impractical. Increasing the number of PIA codes to be considered, as you suggest, would identify more potential special taxpayers. However, this would obviously involve a very large program that would require considerable increased expenditures of time, human resources and funds. Considering also the low tax rate involved ($24, $54) here, we do not believe that from a cost/benefit standpoint exact implementation of this recommendation should be considered.

However, we do essentially agree with the basic concepts inherent in your recommendations. To that point, BATF has developed and begun to implement a retail special tax program (see Attachment #1).

While this program does not coincide exactly with your recommendations, we feel, based on our knowledge and experience, that this is a viable program that will enhance compliance and increase collections of retail special tax. Since these are our mutual aims and we believe this program will attain those aims, this is the program we intend to carry out.

The only difficulty we foresee in carrying out this program fully is the possibility that reduced resources brought about by Gramm-Rudman may cause us to reduce the scope of the program.

2. Congressional Considerations

We continue to oppose the repeal of retail special taxes. As indicated in the report, we view such repeal as having a detrimental effect to our overall law enforcement effort.

The draft report also mentions proposed legislation submitted by the Bureau. The proposed legislation relates to sales of alcohol beverages between wholesalers and retailers. The proposed legislation has been approved by both Treasury and Office of Management and Budget and has been forwarded to the Congress. The legislation has not, to date, been introduced. We continue to advocate this legislation.

B. NFA SPECIAL TAXES

1. Recommendations for BATF Action

One of the issues you discuss is the possibility that some former NFA dealers may unknowingly be in violation of state or local laws prohibiting citizens from possessing NFA weapons they may have acquired as NFA dealers. You make two recommendations related to such situations.

Before we address your recommendations we wish to note that it has been our experience that most NFA dealers are aware of their state/local laws relating to private ownership of NFA weapons. In fact, we believe this knowledge is what prompts a person to register as a NFA dealer. They register with the Federal Government so they may legally possess NFA weapons that would otherwise be illegal were they not a registered dealer.

While we agree the situation you discuss probably exists, we do not intend to implement the first of your recommendations. The process of identifying all former NFA dealers who, by record, possessed NFA weapons at the time they discontinued being a dealer; determining which former dealers resided in jurisdictions that prohibited private ownership of NFA weapons and then mailing some form of notification to such persons would place a considerable administrative burden on the Bureau. Considering this and the fact that the Bureau is precluded from enlisting the aid of states or local jurisdictions in this matter because of tax information involved and, as you point out, private possession of an NFA weapon by a former dealer is not a violation of Federal law, we do not intend to pursue your first recommendation.

However, we do intend to implement your second recommendation. A procedure will be developed whereby all current and future NFA dealers will be informed that should they cease to be a dealer and still possess NFA weapons, they should be aware that some state and/or local jurisdictions forbid private ownership of NFA weapons.

2. Congressional Considerations

The four legislative considerations you suggest all relate to the issue of individuals opting to become NFA dealers in order to build their own firearms collections while avoiding the per weapon transfer tax. We agree with your conclusions that certainly this does occur. Your suggested legislative considerations are well presented and are directed toward eliminating such situations.

The Bureau has also been concerned with such situations. In fact, in response to a request from Senator Robert Dole requesting our views on certain proposals to amend the National Firearms Act, the Bureau has offered proposals relating to this spurious dealer situation. Specifically, we have forwarded three proposals relating to this problem.

In the analysis of your legislative suggestions you point out a number of disadvantages that could be encountered both by taxpayers and BATF should the suggestions be implemented. We agree that there is a distinct potential for these disadvantages to occur. We believe that our three proposals would not only eliminate the problem, provide for more orderly trade in NFA weapons, but would, at the same time, be easier to administer from both a taxpayer and a Bureau point of view. The three legislative proposals mentioned above are attached (Attachment 2, 3, 4). We advocate consideration of these proposals.

We have no other comments to make regarding the issues discussed in the draft report. Again, thank you for the opportunity to comment on this report.

Attachments

Attachment #1

AUG 2 1985

C:P:S:RPM
5000

MEMORANDUM TO: All Regional Directors (Compliance)

FROM: Associate Director (Compliance Operations)

SUBJECT: Special Occupational Tax Collection Program

The attached Special Occupational Tax Collection Program has been adopted. Your comments were given careful consideration and several recommendations were incorporated into the final plan. Suggestions that were not initially adopted will remain under consideration as the program is implemented and special situations arise. In the early phase of implementation, however, I feel it is imperative that we maintain a consistent, National approach to these liabilities. If circumstances later warrant, alternative approaches within the program will be considered.

Each region expressed a common concern regarding managerial latitude in executing this program. Not only does such latitude currently exist, its exercise is mandated. When working with an initiative so broad in scope, problems unique to individual regions will certainly surface. Decisions will be necessary regarding the cost-effectiveness of field investigation of unresolved liabilities. Regional management will make decisions regarding criteria and methodology of referral of information from Technical Services to the Chief, Field Operations. It is only through active regional management that this program will succeed.

Communication is also critical to the full success of this program. As problems are encountered and resolved, and as new initatives are employed, I expect to be informed. On a monthly basis, I will also need statistical data to make decisions regarding future directions of the program. Guidelines regarding these issues - as well as Operating Plan information - are attached. Questions, comments, and reporting data should be forwarded to Bob Mosley, PPA Staff, at 566-7024.

William T. Drake

Attachments

SPECIAL TAX COLLECTION
PROGRAM

The following program for the collection of Special Occupational Tax is keyed to the flow chart that is Exhibit #1. Each step of the process has been numbered in the flow chart to simplify discussion.

A. The information base for the program will consist of (1) TDI's for each state, received from the IRS and assembled in regional offices, (2) an initial listing of potentially delinquent taxpayers made by comparing the current State listing of licensees with the listing of Special Tax Payers for the same period, and (3) the State's monthly listing of newly licensed retailers. While (1) and (3) will be updated continually, (2) will only be necessary when setting up the program.

The volume of TDI's on hand in many regional offices precludes using TDI's on hand to establish a base of information. It is recommended that only current TDI's (those arriving in the regional office after the implementation of the program) be used in establishing a data base.

B. Technical Services supervisors will divide the lists among Stay-In-School employees assigned responsibility for each state (4).

C. While the program will utilize Stay-In-School employees (4), full-time employees will be responsible for training, overseeing the division and assignment of work, answering employee questions, responding to more complex questions from taxpayers, overseeing productivity, and generally supervising the Stay-In-School employees.

D. The Stay-In-School employee will enter taxpayer contact information into a control log (5)(see Exhibit #2) as certified mailings are made. Although taxpayer contacts will be limited to the mail, the taxpayer will be provided a regional office phone number should he/she have a question about the liability. (Note: The log mentioned here and outlined in Exhibit #2 will be used at every key point in the contact/collection/referral process. Each entry in the log will not be mentioned in this outline, but is self-evident in the recommended format of the log).

E. The Stay-In-School employee will mail the taxpayer ATF F 5630.3, a standard letter of inquiry regarding potential Special Tax liability (6). This mailing will be by certified mail (return receipt requested).

F. If no response is received within 30 days of the return of the certified receipt, the information MAY be referred to the Chief, Field Operations (7). Two factors are important in this potential referral. First, the apparent potential tax liability must be considered prior to assigning field personnel to pursue the potential violation. Because each liability situation is unique, however, no monetary guidelines are established by this program. Second, some field follow-up of unanswered inquiries or known liabilities must be made to preserve the integrity of the system. Since individual tax liabilities may be relatively low, a collection may be not be perceived as cost-effective. Further consideration should be given, however, to future compliance on the part of the taxpayer, as well as that of others in the taxpayer's general locale.

[Note: CFO referrals will terminate Technical Services involvement in the specific inquiry. CFO's WILL provide information to Technical Services about the resolution of the referral (amount of tax collected, periods of liability, no action, etc.) for statistical reporting purposes].

G. If the taxpayer responds with a statement of no liability (8), the response will be forwarded to the technical services supervisor (9) for evaluation. If it is the Technical Services supervisor's judgment that no liability does exist, the response will be accepted and the inquiry logged as closed (10). If the lead came from a TDI, IRS should be notified of the non-liability to preclude the issuance of further notices (11). As in the case of the CFO referrals, Regional management will determine the guidelines employed by the Technical Services supervisor in determining which non-liability statements are accepted.

H. If the statement of non-liability is not accepted (12), the Technical Services supervisor will refer this information to the Chief, Field Operations. The Chief, Field Operations, will then determine what action, if any, is appropriate (7). In any case, this referral will terminate any Technical Services involvement in the collection process, other than statistical reporting of the results.

I. If initial or subsequent liability inquiries indicate a liability, the Stay-In-School employee computes the liability and mails a completed Form 11 with instructions for payment, ATF F 5630.4, by certified mail (return receipt requested) (14). A referral will be made to the Chief, Field Operations, 30 days after the certification of receipt, if payment is not forthcoming (15).

J. After the retailer remits payment (16), the payment is logged in the Technical Services control book, and the check forwarded to IRS (17). The data from the T.S. control log is entered on the Technical Services monthly report (ATF F 5700.17) (18), which is then submitted to the Strategic Planning Section for consolidation and reporting to the AD(CO) (19). Until further notified, the regions will also report on a monthly basis additional information regarding the collection program. The requirements for this reporting are outlined separately.

Attachment #2

PROPOSED AMENDMENT TO REQUIRE AN APPLICATION TO ENGAGE IN BUSINESS AS AN IMPORTER, MANUFACTURER OR DEALER IN NFA WEAPONS AND TO CHANGE THE PLACE OF FILING OF SUCH APPLICATIONS

Section 5802 of Title 26 of the United States Code is hereby amended to read as follows:

"On first engaging in business and thereafter or before the first day of July of each year, each importer, manufacturer, and dealer in firearms shall file an application to register with the Secretary in each State in which such business is to be carried on, his name, including any trade name, and the address of each location in the State where he will conduct such business. Where there is a change during the taxable year in the location of, or the trade name used in, such business, the importer, manufacturer, or dealer shall file an application with the Secretary to amend his registration. Firearms operations of an importer, manufacturer, or dealer may not be commenced prior to approval by the Secretary of the application."

ANALYSIS

The purpose of the amendment is to provide that the Secretary of the Treasury may, by regulations, designate the place where importers, manufacturers and dealers in certain firearms shall register with the Secretary, and to require importers, manufacturers and dealers in certain firearms file an application with the Secretary to engage in such business.

The proposed section amends section 5802 relating to the place where importers, manufacturers, and dealers in firearms (as defined in section 5845) shall register with the Secretary. The amendment would repeal the requirement that such persons register in each internal revenue district in which their business is to be carried on and would provide that they shall register in each State in which such business is to be carried on.

The proposed bill would also require importers, manufacturers and dealers in NFA weapons to file an application with the Secretary to engage in their respective businesses. Under existing law Federal firearms licensees under the Gun Control Act of 1968, 18 U.S.C. Chapter 44, merely register with the Secretary and pay the requisite tax in order to engage in business. This has allowed certain dealers to pay the occupational

tax and acquire NFA weapons in interstate commerce and avoid the payment of the $200 transfer tax imposed on nonlicensees. Thus, these dealers rather than engaging in an NFA business are merely acquiring firearms for their personal collections and avoiding the applicable tax. The amendment would provide that the Secretary could ensure that such persons are engaged in a bonafide business.

Attachment #3

PROPOSED AMENDMENT TO THE DEFINITION OF TRANSFER

Section 5845(j), is amended by adding at the end thereof the following: "The term shall also include the retention of any firearm by any individual who has paid the special (occupational) tax as defined in section 5801, and who subsequently discontinues business in such firearms.

ANALYSIS

This provision will ensure that NFA weapons acquired tax-free by dealers are not being acquired merely for the dealers' private collection.

In recent years, licensed firearms dealers under the Gun Control Act of 1968 have paid the $200 special (occupational) tax to become dealers in NFA weapons in order to obtain NFA weapons without having to pay the requisite transfer tax ($200). However, some of these individuals are qualifying as NFA dealers merely to obtain machineguns for their personal collections. In some instances they will acquire numerous NFA weapons and then fail to renew their tax stamp. They have, therefore, acquired their weapons tax-free for their private collections and have avoided payment of the applicable tax. This amendment will ensure that the retention of their weapons after the discontinuance of their business in such weapons incurs the appropriate tax.

Attachment #4

PROPOSED AMENDMENT TO THE IMPORTATION PROVISION
(NEW MATERIAL UNDERSCORED)

26 U.S.C. § 5844--IMPORTATION

No firearm shall be imported . . . unless the importer establishes . . . that the firearm to be imported . . . is . . .

"(3) being imported or brought in solely for testing or use as a model by a registered manufacturer or in the case of a firearm other than a curio or relic as determined by the Secretary for purposes of title 18, United States Code, Chapter 44, solely for use as a sample by a registered importer or registered dealer.

ANALYSIS

As provided by 26 U.S.C. 5844, NFA weapons are prohibited from importation except from under narrow circumstances, e.g., weapons imported for State agencies and political subdivision and weapons imported by registered dealers for use as sales samples to generate sales to State and local governmental entities such as police departments. As in the case of weapons obtained from domestic sources, sales samples are being acquired by certain dealers to enhance their personal firearms collections. A review of the characteristics of these imported "sales samples" indicates they are, in fact, curio or relic firearms and are more suitable as collectors' items than for the official use of governmental entities such as police departments.

This proposal is intended to discourage such importations for personal use.

Advance Comments From the Commissioner of Internal Revenue

Note: GAO's comment supplementing those in the report text appears at the end of this appendix.

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

FEB 12 1986

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

Thank you for the opportunity to comment on your draft report entitled, "Tax Administration: Occupational and Related Excise Taxes."

We do not believe the recommendations in this area would have a significant enough impact on either voluntary compliance or revenues to justify their implementation. We have enclosed detailed comments regarding the report recommendations affecting the Service as well as additional comments on the report text.

We hope these comments will be helpful in preparing your final response.

With kind regards,

Sincerely,

Roscoe Egger

Enclosures

Department of the Treasury Internal Revenue Service

IRS COMMENTS ON GAO DRAFT REPORT
"TAX ADMINISTRATION: OCCUPATIONAL AND
RELATED EXCISE TAXES"

Now on p. 42.

RECOMMENDATION TO IRS (Page 41)

To increase wagering tax revenue and taxpayer compliance, we recommend that the Commissioner of Internal Revenue:

Obtain gambling license data from the states where gambling activities subject to the wagering taxes are authorized and match it with the yearly occupational tax payment records and the tax on gross wagers payment records to identify for followup potential noncompliant taxpayers.

COMMENTS

GAO notes that some revenue is being lost through noncompliance with the tax on gross wagers although they note that the compliance levels are generally high and the revenues relatively low in the two states reviewed. GAO suggests that compliance could be further improved in these states by matching data and following up on noncompliant taxpayers and asserts that IRS could find less-costly methods of doing this.

Our Cperations staff believes that given the relatively high rate of compliance in these states, and in view of the need to allocate scarce resources to other areas of documented low compliance, no additional expenditure of resources is recommended at this time. Even the less-costly methods of follow-up suggested by GAO can often exceed the tax to be collected.

Now on p. 42.

RECOMMENDATIONS TO IRS (Page 41)

Compare tax on gross wagers payment records with the yearly occupational tax payment records for businesses in states which do not license establishments subject to the taxes to identify for followup potential noncompliance taxpayers.

Match the names of employees/agents listed on the employers' occupational tax returns with occupational tax payment records to identify for followup potential noncompliant taxpayers. For the match to be effective, the requirement that employers list employees/agents on their occupational tax returns should be enforced.

COMMENTS

GAO acknowledges that they are unsure of the present filing universe in the states with unauthorized gambling activities and whether these recommendations would have a

significant impact on tax compliance. The wagering tax law, from its inception, was intended to combat organized crime and other elements that are harmful to society. The taxpayers we investigate for wagering violations overwhelmingly fail to file other returns.

The wagering tax law was not intended as a revenue-producing mechanism. This conclusion is supported by the fact the occupational tax and the excise tax is substantially lower in those states where this type of activity is legal and regulated. In states that authorize wagering, the occupational tax is $50, compared to $500 in states where wagering is unauthorized; the excise tax is .25%, compared to 2% (See P.L. 97-362).

Comparing tax on gross wagers payment records with occupational tax payment records for businesses in states which do not license establishments subject to wagering taxes would have little, if any, benefit to our criminal investigation function or other areas of the Service. Most of our wagering investigations result from our own case development efforts and deal with elements of organized crime or other highly sophisticated and large-scale operations.

Now on p. 42.

RECOMMENDATION TO IRS (Page 41)

To reduce costs of administering the tax on gross wagers, we also recommend that the Commissioner of Internal Revenue revise the filing requirement for the tax on gross wagers so that monthly returns will not be required unless an established dollar threshold is met.

COMMENTS

We believe any savings from this recommendation would be negligible in light of the relatively minimal processing costs now incurred: $1.35 for each Form 730, Tax on Wagering, with a projected tax year 1986 filing universe of only 25,000 returns. Revising the current monthly filing requirement also would likely generate more in overhead costs (programming, changing forms and instructions, alerting taxpayers, etc.) than it would save in processing costs. Our compliance activities are very concerned that such a change would create taxpayer uncertainty, break established filing habits, and effect the Service's ability to identify trends, patterns, and nonfilers. We would, of course, be pleased to review this further if any additional information becomes available to verify cost savings or minimize compliance impact.

RECOMMENDATION TO DIRECTOR BATF (Page 30)

Identify for followup potentially noncompliant retail alcohol establishments by arranging for IRS to match occupational tax payment data with businesses classified under selected principal industry activity codes.

COMMENTS

We have discussed this recommendation at the staff level with BATF representatives and would be willing to discuss this issue further if BATF decides to pursue this project.

TECHNICAL COMMENTS

Now on p. 35.

Page 34, last sentence to end of paragraph on page 35: "According to Ogden Service Center officials, the apparent omission of this information is not a basis for rejecting the returns and followup contacts are not normally made."

COMMENTS

The Internal Revenue Manual 3(11)(23)0 requires that correspondence with the taxpayer must be made if all necessary information is not supplied. The statement that omission of the names of employees/agents from Form 11C is not a basis for followup contact with the filer is inconsistent with National Office procedures as contained in the Manual.

Page 39, Paragraph 1, Sentence 1 and 2: "The only other excise tax return with a potential monthly filing requirement is the Form 720, Quarterly Federal Excise Tax Return. The criterion for this return states that it must be filed monthly unless taxes due are $100 or less in which case the tax liability is carried over until the next month."

COMMENTS

See comment 1.

Form 720 is not the only other excise tax return with potential monthly filing requirements. Form 2290, Heavy Vehicle Use Tax Return, also an excise tax return, has a potential monthly filing requirement.

The second sentence could be clarified as follows: "When it is determined that a taxpayer is not complying with the proper filing and paying of Form 720, Quarterly Federal Excise Tax Return, monthly filing and payment of tax can be imposed unless taxes due are $100.00 or less in which case the tax liability is carried over until the next month. The $100 threshold cited for filing Form 720 refers to the requirements contained in Treasury Regulation 48.6011(b)(1), which provides that a District Director may require, in certain situations, a taxpayer to file a monthly or semimonthly return on Form 720.

The following is GAO's comment on the Internal Revenue Service's letter dated February 12, 1986.

GAO Comment

1. We revised the sentences dealing with the Form 720, Quarterly Federal Excise Tax Return, along the lines suggested by IRS.

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