

# TTB Audits: What to Expect

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# TTB Disclaimer

This information is being presented to help the public to understand and comply with the laws and regulations that the Alcohol and Tobacco Tax and Trade Bureau (TTB) administers.

It is not intended to establish any new, or change any existing definitions, interpretations, standards, or procedures regarding those laws and regulations.

In addition, this presentation may be made obsolete by changes in laws and regulations.

Please consult the applicable laws and regulations for the most current requirements.



# Agenda

- Background
- TTB's Tax Audit Division (TAD) Mission & Structure
- Overview of Audit Process
- The Excise Tax Audit Phases
- Common Audit Findings
- How to Prepare for Your Next TTB Excise Tax Audit
- Informational Resources



# Background

- Legal Framework
- Statutory Authority: 26 U.S.C. 4181
- FAET Tax Collections Trend
- Disposition of the Revenue
- Definition of a Firearm
- Definition of Ammunition



# Legal Framework

- **Title 26 United States Code** – Internal Revenue Code (26 U.S.C.)
- **Title 27 Code of Federal Regulations** – Alcohol, Tobacco Products, and Firearms: this presentation focuses on Part 53, which contains TTB’s firearms and ammunition regulations (27 CFR Part 53)
- **Interpretive Guidance on TTB’s Website** – IRS Revenue Rulings, ATF Rulings, TTB Rulings, Industry Circulars, Announcements
- **Interpretive Guidance Not on TTB’s Website** – IRS Private Letter Rulings, ATF Letter Rulings, TTB Technical Advice Letters



# Statutes

## 26 U.S. Code

- 4181 – The excise tax
- 4182 – Tax-exemptions
- 4216 – Definition of price (inclusions, exclusions, & constructive sale price)
- 4218 – Business use
- 4221 – Tax-free sales
- 6416 – Condition to allowance, price readjustments
- There are additional statutes related to penalties



# Regulations

## **27 CFR Part 53 – Manufacturers Excise Tax-Firearms and Ammunition**

- Federal regulations are the primary means by which federal agencies exercise their statutory authority to carry out the federal government's regulatory intentions.
- TTB has issued regulations implementing its previously mentioned FAET related statutory authorities at 27 CFR part 53.



# Revenue Rulings

- An official interpretation by TTB or its predecessor agencies (IRS/ATF) concerning the Internal Revenue Code, related statutes, tax treaties, and regulations
- Represent the conclusions of TTB regarding the application of the law to the pivotal facts stated in the revenue ruling. TTB generally relies on the FAET related rulings of its predecessor agencies (IRS/ATF).





# Additional Sources

- Industry Circulars
  - Issued by TTB to guide industry and establish best practices
- Technical Advice Letter
  - Issued to a specific taxpayer asking a specific question
- Other guidance on TTB website
- Instructions on the Tax forms



# Ad Valorem Tax

FAET is an ad valorem excise tax. It is based according to price and is typically imposed at the time of the sale transaction.

Other commodities that we regulate (except large cigars) are taxed based on units, pounds, gallons, etc.



# Where FAET Begins: 26 U.S.C. 4181

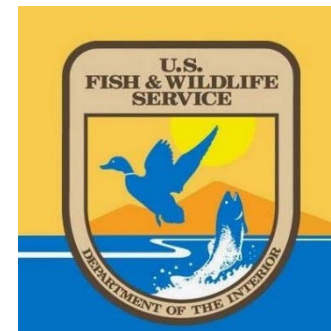
## Imposition of Tax

There is hereby imposed upon the sale by the manufacturer, producer, or importer of the following articles a tax equivalent to the specified percent of the price for which so sold:

- Articles taxable at 10%:
  - Pistols
  - Revolvers
- Articles taxable at 11%:
  - Firearms (other than pistols and revolvers)
  - Shells, and cartridges



# Disposition of Revenue



**Pittman-Robertson Wildlife Restoration Act of 1937:** Mandates that all FAET revenue (and bow and arrow revenue) be used for federal aid to wildlife restoration fund, hunter safety programs and maintenance of public target ranges for execution of programs. This money is distributed to the states.

**Department of the Interior (Fish and Wildlife Service)** is responsible for administration of the trust fund. The Secretary of the Interior can deduct up to a set amount of collected revenues for administration.

By contrast, TTB administers and collects this money and receives no portion of collections for its administrative costs.



# Definition of a Firearm

**Firearms** are “Any portable weapons...from which a shot, bullet, or other projectile may be discharged by an explosive.” (See 27 CFR 53.11)

Non-firearms under this definition include:

- Starter pistols
- BB guns
- Trade show guns (if firing mechanism is disabled)



# What Does Portable Mean?

- **Portability of Firearm:** TTB has interpreted the term **portable** in a common-sense manner to mean that the weapon is capable of being carried by a person.
- **ATF Ruling 97-2:** A weapon with a weight of 30 pounds or less, with additional weight for ammunition and spare parts, was considered a **portable weapon** within the definition of firearm.
- Firearms weighing more than 30 pounds may also be **portable** weapons.

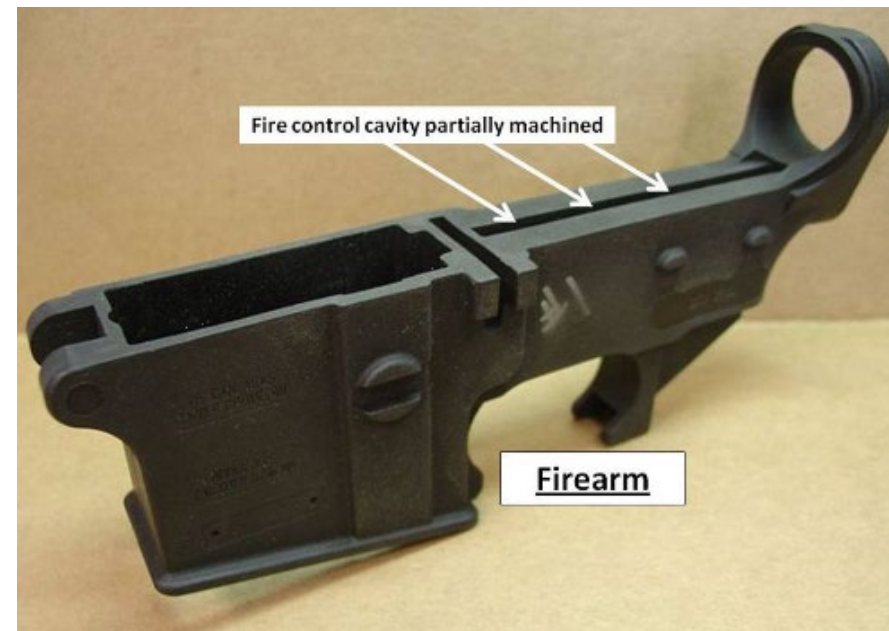


# Definition of a Firearm

TTB's definition of a firearm is very different than ATF's definition under the Gun Control Act of 1968.

For instance:

- ATF considers receivers like the one pictured to be a firearm. TTB doesn't.
- ATF does not consider many muzzle loading guns to be firearms. TTB does.





# Knockdown Condition

**Knockdown condition:** A taxable article that is unassembled but complete as to all component parts.

A manufacturer who sells a taxable article in a **knockdown condition** is liable for the tax even if they sell it as separate parts or on separate invoices.





# Definition of Ammunition

Shells and cartridges “Include any article consisting of a projectile, explosive, and container that is designed, assembled, and ready for use without further manufacture in firearms, pistols, or revolvers.” (See 27 CFR 53.11)



Most notable example of what doesn't fall under this definition?

Blank ammunition

(explosive and container, but no projectile)



# Example: Training Guns & Ammunition

- Paint-ball training pistols.
- Designed to feel, weigh, and perform like a normal pistol.
- These training pistols were colorful to help indicate that they were non-lethal.



# Example: Training Guns & Ammunition

- **Pistols** – Small projectile firearms which have a short one-hand stock or butt at an angle to the line of bore and a short barrel or barrels, and which are designed, made, and intended to be aimed and fired from one hand.
- **Firearms** – Any portable weapons, such as rifles, carbines, machine guns, shotguns, or fowling pieces, from which a shot, bullet, or other projectile may be discharged by an explosive.



# Example: Training Guns & Ammunition

- The **training pistol** is considered a taxable pistol.
  - Fits the definition of **pistol**
  - Complete as to all component parts
  - Percussion caps ignite the cartridge which contains gun powder for an explosive charge
  - Discharges a projectile



# Ammunition Reloading

## 27 CFR 53.11 – Shells and Cartridges

- “A person who reloads used shell or cartridge casings is a manufacturer of shells or cartridges within the meaning of section 4181 if such reloaded shells or cartridges are sold by the reloader.”



# Ammunition Reloading

## 27 CFR 53.11 – Shells and Cartridges

- [T]he reloader is not a manufacturer of shells or cartridges if, in return for a fee and expenses, he reloads casings of shells and cartridges submitted by a customer and returns the reloaded shells or cartridges with identical casings provided by the customer to that customer. Under such circumstances, the customer would be the manufacturer of the shells or cartridges and may be liable for tax on the sale of articles.



# Ammunition Reloading

- Court case involving an ammunition reloader, United States v. Bachman, 2003 U.S. Dist LEXIS 111548 (E.D. Pa. 2003).
- The court, citing **revenue ruling 56-209**:

This excise tax is not applicable where the manufacturer merely reloads shells belonging to his customer and is paid for his labor and materials. However, for this exemption to apply there must be a return to the customer of the identical shells tendered by the customer for reloading. It is not applicable if, instead of a return of the identical shells, an equivalent number is withdrawn from the inventory of the reloader. Such an exchange is regarded as a taxable sale.



# Ammunition Reloading

## TAXPAYER

- Acquire casings, reload, and sell to customers
- Reload customer's casings for a nominal fee and customer subsequently re-sells the reloaded ammo, the customer is the taxpayer

## NOT TAXPAYER

- Acquire casings, reload, and use yourself
- Reload customer's casings for a nominal fee, customer uses the ammunition for their personal use.





# QUESTIONS?

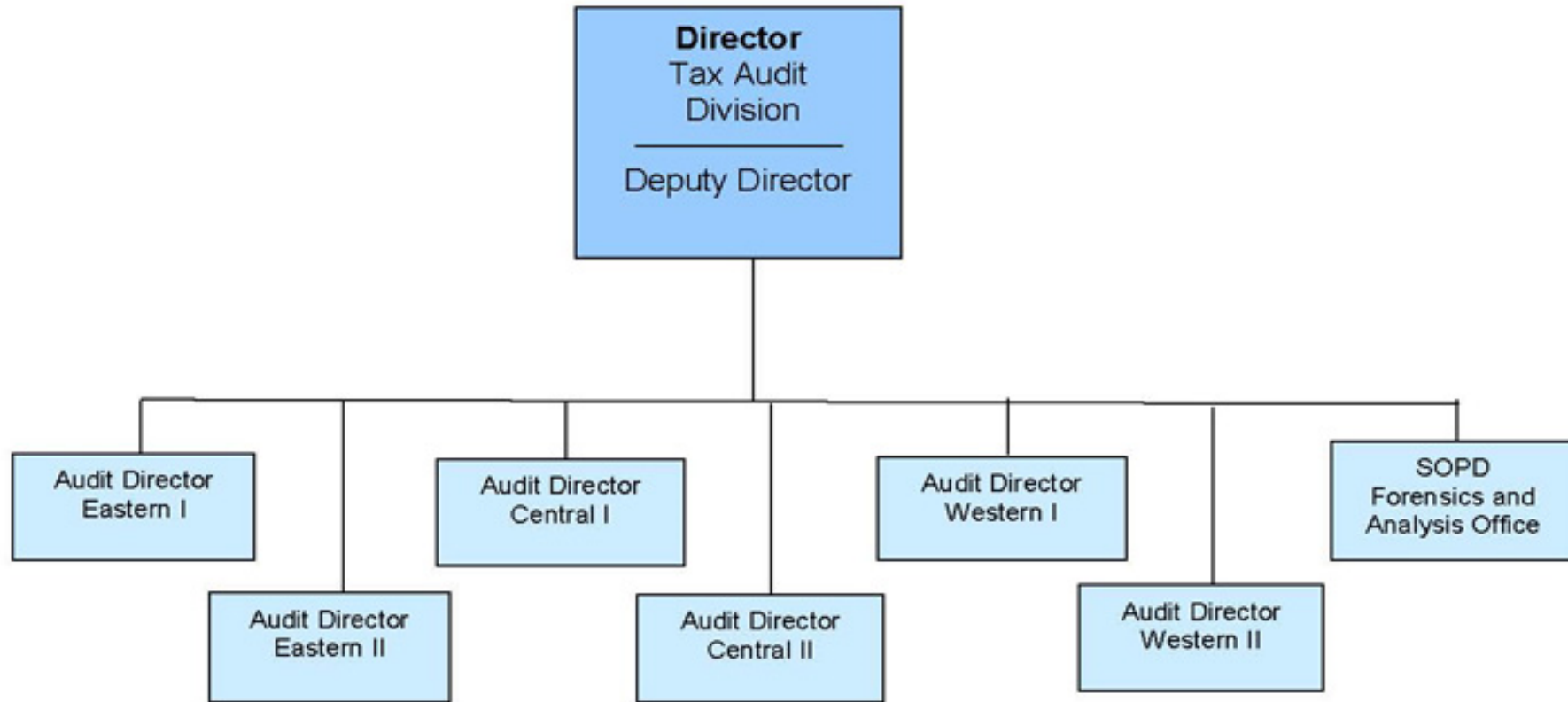


# Tax Audit Division

TAD's mission is to ensure the proper payment of federal excise taxes and compliance with laws and regulations in a manner that protects the tax revenue and prevents unlawful activity in the commodities TTB regulates.



# Tax Audit Division Organization



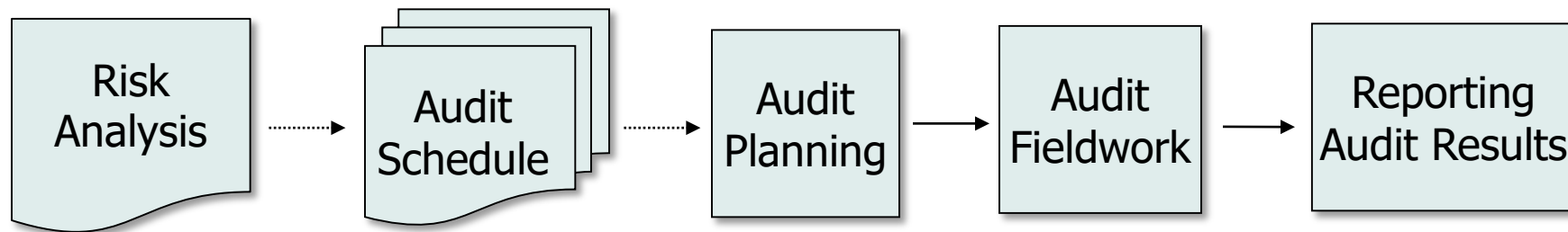


# Professional Audit Standards

- Our audits are conducted in accordance with auditing standards that incorporate Generally Accepted Government Auditing Standards (Yellow Book) published by the U.S. Government Accountability Office (GAO).
- Our audits focus on promoting voluntary compliance by partnering with industry members using a “no surprises” approach to provide a value-added service for both the industries and TTB.



# TTB Audit Process





# Risk Assessment

Industry Members are evaluated on basic risk factors for audits:

- Size: TTB is congressionally mandated to audit 95% of the revenue, which means the larger the industry member the more likely an audit is necessary.
- Changes in Business: significant increase/decrease in revenue; non-filing of returns; filing for bankruptcy.
- Changes in the Industry: new businesses and unique products



# Audit Schedule

Once and industry member is selected for audit:

- Determine the type of engagement (audit, limited scope audit, review)
- Issue an engagement letter
- Make first contact with responsible person of the industry member
- Discuss auditor needs, the purpose of the audit, and the goals of the audit



# Planning the Audit

## Taxpayer Information Request List

A **Taxpayer Information Request List** may include requests for the following information:

- Sales register in electronic format (e.g. Excel, Access)
- Tax computation files
- Tax-free registration
- Support for tax-free and tax-exempt sales
- Support for eligible adjustments
- Support for claims for credit





# Planning the Audit

## Taxpayer Information Request List (Continued)

- Sales catalogs and price lists
- Federal firearms licenses
- ATF Bound Book
- Chart of accounts, general ledger, financial statements, bank statements
- Corporate income tax and sales tax returns
- Internal records such as organization charts, written internal control procedures, and corporate minutes



# Audit Fieldwork

- Opening conference and tour of the operation
- Interview subject matter experts, including accounting and/or government compliance personnel
- Review of records and testing of transactions
- Assess or evaluate the effectiveness of applicable internal controls
- Identification of audit issues or findings



# Audit Fieldwork (Continued)

- For a full scope audit, a typical audit team is an auditor-in-charge plus 1 or 2 staff auditors, onsite for 2 weeks
- After onsite fieldwork, audits usually continue from the auditors' home offices
  - More onsite fieldwork can be necessary, especially if taxpayers are not providing needed info
- Limited scope desk reviews may require no onsite work.



# Audit Fieldwork (Continued)

## Records (Audit Trail)

We must be able to verify that all sales and uses subject to FAET have been reported at the correct price and any reductions (tax-free or exempt, eligible adjustments, and claims for credit) are properly calculated and supported:

- FAET Returns
- Summary records and reports
- Daily transaction records
- Verify completeness of above with sales register



# Reporting Audit Results

- Management Letter to industry member
  - Tax Adjustments
  - Compliance Violations
  - Internal Control Weaknesses
- Written response from industry member (if any)
- Audit Report (internal TTB)



# Common Audit Findings

Some examples of common TTB audit findings include:

- Failure to file tax returns
- Failure to pay tax
- Late tax returns and/or payments
- Not reporting all sales and uses on line 8



# Common Audit Findings (Continued)

- Reporting nontaxable articles sold separately on line 8, usually with a deduction later on the return
- Reporting activity related to prior period sales on lines 8 through 16 of the tax return (especially: netting product returns against current period sales on line 8)



# Common Audit Findings (Continued)

- Disallowed freight exclusion due to not using actual costs or not having support
- Disallowed freight exclusion due to not using a relative weight method or other approved method
- Disallowed nontaxable articles exclusion due to obsolete or incorrect cost data or lack of support





# Common Audit Findings (Continued)

- National Firearms Act sales – treating them as tax-exempt without paying the transfer tax or excluding them from the return entirely
- Failure to obtain a tax-free registration
- Lack of adequate support for tax-free or exempt sales



# How to Prepare for Your Next TTB Excise Tax Audit

- Timely pay your federal excise taxes and timely file your returns!
- Be aware of and follow the laws and regulatory requirements.
- Audit yourself.



# Informational Resources

## Title 27 Code of Federal Regulations (CFR), Part 53

- Available online: <http://www.ecfr.gov/>

## TTB.gov

- FAET homepage: <https://www.ttb.gov/firearms>
- Forms: <https://www.ttb.gov/firearms/forms>
- Pay.gov: <https://www.ttb.gov/what-we-do/taxes-and-filing/pay-gov>

## TTB Newsletter

- Subscribe to TTB's weekly newsletter:  
<https://www.ttb.gov/resources/publications/ttb-newsletter>

## National Revenue Center

- Full contact info: <https://www.ttb.gov/who-we-are/contact-us/nrc-call-center>



# Summary

- All audits are completed in accordance with professional auditing standards.
- TAD's audit process begins with risk analysis and an audit schedule.
- All excise tax audits include **5 phases**: Risk Assessment, Scheduling, Planning, Fieldwork and Reporting.
- Be prepared for your next excise tax audit.
- Take advantage of TTB's available informational resources!