REPORT TO THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION CONGRESS OF THE UNITED STATES

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

Occupational Taxes On The Alcohol Industry Should Be Repealed

Bureau of Alcohol, Tobacco and Firearms

Department of the Treasury

Occupational taxes on the alcohol industry are not being adequately enforced, but repeal appears preferable to additional enforcement. Also the Bureau's authority to conduct investigations under the Federal Alcohol Administration Act needs to be clarified.

GGD-75-111

JAN. 16, 1976

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-137762

To the Chairman and Vice Chairman
Joint Committee on Internal
Revenue Taxation
Congress of the United States

Your June 18, 1973, letter asked us to study all facets of Government regulation of the alcohol and tobacco industries. This report deals with two facets--the relevance of occupational taxes on the alcohol industry in todays financial environment, and the questionable legality of present investigative techniques used by the Bureau of Alcohol, Tobacco and Firearms in enforcing the Federal Alcohol Administration Act.

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; and the Director, Bureau of Alcohol, Tobacco and Firearms.

Comptroller General
of the United States

Contents

ABBREVIATIONS

ATF	Bureau of Alcohol, Tobacco & Firearms
FAA	Federal Alcohol Administration
GAO	General Accounting Office
IRS	Internal Revenue Service

COMPTROLLER GENERAL'S REPORT TO THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

OCCUPATIONAL TAXES ON THE ALCOHOL INDUSTRY SHOULD BE REPEALED

Bureau of Alcohol, Tobacco and Firearms
Department of the Treasury

D I G E S T

Federal occupational taxes must be paid before an individual or corporation can legally engage in a trade or business as a retail or wholesale dealer in distilled spirits, wines, or beer; manufacturer of nonbeverage alcoholic products; brewer; manufacturer of stills; and/or a rectifier (purifying distilled spirits or wine or mixing them with other materials under the name of whiskey, brandy, rum, gin, or wine). (See p. 1.)

Taxes differ by occupation and range from $24 annually for a retail dealer in beer to $255 annually for a wholesale liquor dealer.

The $54 annual tax on retail dealers in distilled spirits produces the most revenue--$16.8 million of the $18.6 million collected in fiscal year 1974 from all sources in the alcohol industry.

Taxpayer compliance with alcohol-related occupational tax laws has dropped below acceptable levels, and enforcement by the Bureau of Alcohol, Tobacco and Firearms is not adequate. Although additional manpower in this area would undoubtedly increase both revenues and compliance, the overriding question is not whether there should be increased enforcement but whether the tax itself ought to be continued. (See pp. 6, 7, 8, and 18.)

Occupational taxes:

--Are not a significant revenue source.

--Are inherently inefficient to collect because they involve the direct collection of small amounts from a relatively large number of taxpayers.

GGD-75-111

--require separate administrative machinery for the Government and impose additional paperwork on the taxpayer.

--Are overshadowed by Federal excise taxes on alcoholic beverages which produce much more revenue and are collected more efficiently.

--Are paralleled by State and local license fees. These governments perform a regulatory function which the Federal Government does not. (See p. 18.)

On balance, repeal of the occupational taxes appears preferable to increased enforcement. The lost revenue could be recouped, if desired, by an almost infinitesimal increase in the excise tax on alcohol. For example, a 6- to 7-cent increase in the $10.50 per gallon excise tax on distilled spirits would accomplish this. (See pp. 18 and 19.)

GAO recommends that the Congress:

--Repeal all occupational taxes in sections 5081 through 5148 of the Internal Revenue Code.

--Amend the Federal Alcohol Administration Act to clarify authority of the Bureau of Alcohol, Tobacco and Firearms to investigate possible consumer and/or unfair trade practice violations of the act prior to a permit hearing. (See p. 22.)

The Bureau of Alcohol, Tobacco and Firearms has relied upon the occupational tax laws as authority to enter the premises of wholesale and retail dealers to search for violations of another law, the Federal Alcohol Administration Act. (See p. 19.)

GAO believes that the inspection authority under the occupational tax laws may not be used to gather evidence of violations of other laws, such as the Federal Alcohol Administration Act, when a primary purpose of the inspection is to discover such evidence. (See pp. 19 and 20.)

Further, a Federal court decision (Serr v. Sullivan) has concluded that investigations for possible violations of the Federal Alcohol Administration Act are authorized only when made in connection with a permit hearing. (See p. 20.)

GAO believes that the Bureau's authority to investigate violations is inadequate and that, if the Bureau is to effectively regulate consumer and unfair trade practices in the alcohol industry, the Congress should clarify the conditions under which such investigations can be made. (See pp. 19 to 22.)

The Bureau opposes the repeal of occupational taxes primarily on the grounds that they are a significant revenue source. However, the Bureau agrees that the Federal Alcohol Administration Act should be amended to clarify the Bureau's authority to investigate violations under that act. (See app. I.)

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CHAPTER 1

INTRODUCTION

In a June 18, 1973, letter, the Joint Committee on Internal Revenue Taxation asked us to review the regulatory activities of the Bureau of Alcohol, Tobacco and Firearms (ATF).

This report stems from that request. It deals with the occupational tax laws under which various elements of the alcohol industry operate and the relationship of these laws to ATF's conduct of Federal Alcohol Administration Act investigations.

OCCUPATIONAL TAX REQUIREMENTS

Federal occupational taxes must be paid before an individual or a corporation can legally engage in a trade or business as a retail or wholesale dealer in distilled spirits, wines, or beer; manufacturer of nonbeverage alcoholic products; brewer; manufacturer of stills; and/or a rectifier. A "rectifier" is one that mixes spirits, wine, or other liquor with any material under the name of whiskey, brandy, rum, gin, or wine. The taxes differ by occupation and range from $24 per annum for a retail dealer in beer to $255 per annum for a wholesale liquor dealer.

The $54 per annum tax on retail dealers in distilled spirits produces the most revenue. Occupational tax revenues from all sources in the alcohol industry amounted to about $18.6 million in fiscal year 1974, of which $16.8 million was collected from retail dealers. The following table shows the tax rate and comparative tax collections from each occupational category.

Classification	Annual tax rate	Fiscal year 1974 collections
Retail dealers:		
Liquor or medicinal spirits	$ 54	$10,849,738
Wines or wines and beer	54	3,483,069
Beer	24	2,487,785
Total		16,820,592
Wholesale dealers:		
Liquor	255	630,100
Wines or wines and beer	255	374,095
Beer	123	582,381
Total		1,586,576
Manufacturers of nonbeverage alcohol products	(a)	115,471
Brewers:		
Less than 500 barrels	55	1,685
500 barrels or more	110	10,290
Total		11,975
Manufacturers of stills	55	3,885
Rectifiers:		
Less than 20,000 proof gallons	110	4,469
20,000 proof gallons or more	220	21,195
Total		25,664
Total collections		$18,564,163

[a]Varies from $25 to $100 depending on the number of proof gallons used.

ATF and the Internal Revenue Service (IRS) jointly administer the occupational tax laws. ATF is charged with enforcement, and IRS processes returns and issues tax stamps.

Owners of each of the aforementioned businesses are required to file a Form 11--Special Tax Return, with remittance, by July 1 of each year to the director of the IRS service center serving the district where the business is located. IRS then processes the return and issues a tax stamp. This stamp is not a license to operate, does not confer any privileges upon the taxpayer, and is not a stamp in the conventional use of the term. It is merely a document which signifies that the occupational tax has been paid.

If business is conducted at more than one location, a tax stamp must be obtained for each, except for retail stores operated by a State or a political subdivision of a State. These entities are required to pay only one tax as retail dealers in distilled spirits, beer, or wine, regardless of the number of locations operated.

If an individual or a business which has previously filed an occupational tax return fails to do so in an ensuing year, IRS notifies ATF for followup or enforcement action. ATF is also responsible for identifying individuals or businesses which have not filed returns. This activity is performed under the authority of 26 U.S.C. 5146(b), which allows ATF inspectors to enter the premises, during business hours, of any occupational taxpayer for the purpose of examining any records or other documents required to be kept under the provisions of chapter 51 of the Internal Revenue Code of 1954.

Willful failure to file an occupational tax return can result in a fine of not more than $5,000 and imprisonment for not more than 2 years, and ATF has on occasion obtained such convictions in the courts. Nonwillfull delinquencies draw an assessment of 5 percent per month on delinquent amounts, not to exceed 25 percent of the aggregate tax, plus interest at 9 percent per annum.

CHAPTER 2

OCCUPATIONAL TAXES NO LONGER A SIGNIFICANT SOURCE OF REVENUE

Occupational taxes have long been used by the Federal Government to generate revenues for government operations. In 1794 a tax of $5 per annum was imposed upon retail dealers in wines or in foreign distilled spirits. The tax remained in effect until 1802 when all internal taxes except that on salt were repealed. The necessities of the War of 1812 forced the Government to adopt new internal taxes in 1813, which included an occupational tax on retail dealers in wine and various liquors. In response to popular pressure, these taxes were repealed in 1817.

The War Between the States caused the Federal Government to turn once more to occupational taxes as a means of raising revenues. At one time such taxes were levied on 51 specified occupations and all others with gross annual receipts over $1,000. Some of the specified occupations were bankers, real estate agents, auctioneers, jugglers, butchers, peddlers, doctors, lawyers, innkeepers, insurance agents, photographers, plumbers, and builders. By 1870, however, the Government was accumulating large surpluses which the Congress believed were leading to fiscal extravagance. Because of these surpluses, it was believed that the revenues from many taxes, including some occupational taxes, were no longer needed and certain of these taxes could be repealed.

In a report submitted to the House Committee on Ways and Means, in 1869, the Special Commissioner on the Revenue argued for repeal of numerous miscellaneous taxes, including all the occupational taxes except those on bankers and manufacturers and dealers in spirits, beer, and tobacco. In 1870, all occupational taxes except those on alcohol and tobacco vocations were repealed. Occupational taxes in the alcohol industry apparently were continued because of their excellent revenue-producing capabilities and a generally held belief that, by taxing the various alcohol industries, the costs would be transferred to the consumer and consumption would decrease. This philosophy was presented on the floor of the House of Representatives by the Chairman of Ways and Means in the following statement:

> "* * * I have hundreds of people coming to me and appealing to me why a man who deals in whiskey should be taxed more than a man who deals in clothing or leather, and I have answered that

the articles in which he deals are suppliers for an artificial appetite, and that we must make the consumers pay for the indulgence."

Since the inception of income taxes on corporations in 1909 and on individuals in 1913, the revenues from taxes on selected alcohol-related occupations have steadily declined compared to total internal revenues. Far from their original status as a major source of tax revenue, these occupational taxes have become comparatively insignificant. In 1908 alcohol-related occupational taxes represented $7.3 million, or 2.9 percent, of the Nation's internal revenue of $252 million. In fiscal year 1974, occupational taxes yielded only $18.6 million of the approximately $269 billion in revenue collected by the Federal Government, or about one ten-thousandth of 1 percent. Furthermore it is not likely that $18.6 million in taxation influences the amount of alcohol consumed when the total retail sales of such beverages exceeds $17 billion per annum.

CHAPTER 3

NONPAYMENT OF OCCUPATIONAL TAXES BY RETAIL DEALERS

To determine the extent to which retail dealers in distilled spirits, beer, and/or wine were paying their occupational taxes, we made a random sampling of retail businesses liable for such taxes in California, Georgia, Illinois, and Ohio. From a possible 98,934 retail dealers, 650 were contacted, of which 174, or 27 percent, were delinquent on at least 1 year's tax. A statistical projection of these results indicated that 24,000 to 33,500 taxpayers could be delinquent in the 4 States, representing an annual revenue loss of $919,000 to $1.9 million.

The sampling plan used to determine the taxpayers to be contacted was developed as follows.

--Communities in California, Georgia, Illinois, and Ohio were placed in three population categories according to 1970 data obtained from the Bureau of the Census--under 10,000 people, 10,000 to 100,000 people, and over 100,000 people.

--ZIP codes identified from the United States Postal Service's National ZIP Code Directory were listed for each population category. A random sample of ZIP codes in each category was then selected as the primary sampling unit.

--A list of every retail dealer operating in the ZIP codes serving as primary sampling units was then developed using State licensee data. A random sample was taken from this list to determine the specific retail dealers to contact. The following table illustrates the results of this process.

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
California:	48,725				
Under 10,000		1,324	3	16	16
10,000-100,000		380	3	175	50
Over 100,000		329	4	176	75
Total		1,733	10	367	141
Georgia:	7,711				
Under 10,000		476	3	22	22
10,000-100,000		43	3	251	60
Over 100,000		55	4	119	57
Total		574	10	392	139
Illinois:	19,484				
Under 10,000		1,247	3	28	28
10,000-100,000		170	3	168	66
Over 100,000		81	4	344	87
Total		1,498	10	540	181
Ohio:	23,014				
Under 10,000		1,042	4	47	40
10,000-100,000		152	4	70	55
Over 100,000		167	5	286	94
Total		1,361	13	403	189
Total	98,934	5,166	43	1,702	650

Although we determined the areas selected for sampling and the establishments to be contacted, ATF inspectors actually contacted the taxpayers. When delinquency was readily established, a Form 11--Special Tax Return--was provided the taxpayer, who was normally given the option of submitting the return, with remittance, to IRS later, or of immediately paying the tax to the inspector. When evidence of payment was not readily available and the matter was questionable, the inspector was to follow up later. Collection data is incomplete because ATF manpower limitations have precluded the completion of followup on some of the aforementioned delinquencies.

When asked why they had not paid their occupational taxes, 113 of the 174 delinquent taxpayers in our sample indicated they were unaware of the tax requirements, 22 indicated they had not received renewal notices from IRS, 19 forget to pay, 8 had no explanations, and the remaining 12 had answers ranging from changed ownership to a lack of understanding of the bill.

Our review did not reveal any noncompliance problem with respect to brewers, rectifiers, wholesalers, or other occupational taxpayers in the alcohol industry. We contacted 15 wholesalers and 2 manufacturers of nonbeverage alcoholic products in Illinois and Ohio and found no delinquencies. This high compliance rate may be attributable to the fact that ATF inspectors are directed to perform regular inspections at brewers, manufacturers of nonbeverage alcoholic products, and wholesalers. During these inspections a determination is made as to whether the occupational taxes have been paid. There is no similar inspection program for retail establishments.

CHAPTER 4

OCCUPATIONAL TAX LAWS NOT EASILY ENFORCED

Enforcement of the occupational tax laws at present consists of visits to retail dealers at which time a routine inquiry is made as to whether the occupational tax has been paid. During most of these same visits, the ATF inspectors also search for violations of the Federal Alcohol Administration (FAA) Act which is intended to protect the consumer and prevent unfair trade practices. In fiscal year 1974 and the first 9 months of fiscal year 1975, 7,962 retail dealers were contacted, of which 1,317 were found delinquent in 1 or more years. As a result, $259,368 in taxes, penalties, and interest were collected.

During the same 21-month period, ATF expended a total of 64 staff-years on occupational tax enforcement and FAA Act investigations. The staff-years that relate solely to occupational taxes cannot be determined.

ATF officials believe that additional revenues could be collected if an effective enforcement program could be developed. The results of our random samples in California, Georgia, Illinois, and Ohio support this contention; but developing an adequate enforcement program is more complex than might be anticipated. The possibilities range from providing ATF with the additional manpower necessary to contact each delinquent, to a limited program wherein new State licensees are contacted by ATF through the [illegible]. However, each has drawbacks.

PROVIDE ATF WITH ADDITIONAL MANPOWER TO CONTACT DELINQUENTS

The most obvious way to increase occupational tax collections and compliance would be to provide ATF with additional inspection and/or clerical personnel to identify and contact delinquents.

ATF has stated that it needs more manpower to collect occupational taxes. In hearings before House and Senate Subcommittees of the respective Committees on Appropriations on ATF's fiscal year 1975 budget request, the Director of ATF cited the Bureau's critical need for additional manpower to carry out its statutory responsibilities. When asked to specify areas of responsibility not being adequately funded, the Director cited the [illegible] tax delinquency problem with respect to retail dealers.

One use of additional manpower would be to deal with delinquents who previously filed returns but had failed to refile and had been referred to ATF by IRS. Referrals from IRS happen this way. Occupational taxpayers on record with IRS automatically receive renewal notices in May. Although the tax payment is due by July 1, IRS does not send the first reminder until August. If a satisfactory response is not received, second and third notices are then sent at about 30-day intervals. If the tax has not been paid within 30 days after the third and final notice, IRS notifies ATF that the taxpayer has failed to file a current tax return and is potentially delinquent.

After IRS specifically identifies the potential delinquent, clerks could telephone or write retail dealers to determine whether they are still in business If warranted, a request for immediate payment of a tax liability could then be made. However, consideration must be given to the fact that these delinquents have already failed to respond to four notices from IRS and may continue to refuse cooperation with ATF. Thus, if full compliance is to be obtained, it appears that inspectors would be needed to supplement the clerical staff and personally contact many of these referrals.

Budget limitations in fiscal years 1974 and 1975 have caused ATF to eliminate plans for followup on IRS referrals. According to ATF, manpower has not been available to follow up on about 40,000 potential delinquents referred by IRS in fiscal year 1973. To compound this problem, additional referrals were received from IRS in fiscal years 1974 and 1975. Although some of these referrals have either gone out of business or paid the tax, many apparently are delinquent. From GAO's random sample of retail dealers in California, Georgia, Illinois, and Ohio, 36 of the 650 taxpayers contacted had been referred to ATF by IRS as potentially delinquent and we found that 23 were, in fact, delinquent.

Additional manpower could also be used to deal with those that have never filed occupational tax returns--a much more difficult task than acting on IRS referrals. One way of detecting these delinquents is to visit their places of business and ask to see the tax stamp. Visits to retail dealers are also made to enforce the FAA Act, so enforcement of both laws through this means can be partly concurrent. At present, less than 36 staff-years per annum are devoted to visiting retail dealers. ATF has estimated that "a viable, ongoing retailers inspection program" would require 326 inspector staff-years per annum and each retail dealer would be contacted once every 4 years.

Without any clear indication that FAA enforcement effort will or should be significantly increased, the question reduces to one of whether the cost would be justified in terms of additional occupational taxes collected. It seems unlikely.

Additional manpower could also be used in conjunction with other approaches to obtaining compliance with the occupational tax law. These approaches are discussed next.

UTILIZE DATA FROM THE STATES TO IDENTIFY DELINQUENTS

In addition to IRS referrals, ATF has on occasion solicited and received data on retail dealers operating in the several States. However, the adequacy of the data for ATF purposes varies. State information currently obtained ranges from complete lists of all retail dealers operating in a given State to the identification of all individuals receiving a license to operate within a specified period. Some of this data is readily usable, some is not.

ATF has attempted, on an experimental basis, to compare State lists of retail dealers to IRS listings containing similar data in order to identify nonfilers of Federal returns. We attempted a similar comparison. Neither attempt was successful because IRS and State lists were not compatible. IRS accumulates its occupational taxpayer information by ZIP code and employer identification number, whereas State data is accumulated by such methods as a stamp or license number, trade name, owner's name, and alphabetic sequence by name or county. Other problems with this approach are that some States do not have license data computerized and some leave responsibility for licensing retail dealers to the municipal governments.

Conversely, ATF has in some instances had success in using State-provided data. In fiscal year 1973 ATF's San Jose, California, area office conducted an enforcement program where 410 retail dealers who had recently obtained State licenses from the California State Alcohol Beverage Control Board were contacted by mail to determine if they had paid the Federal occupational tax. Of the dealers contacted, 355, or 87 percent, responded that they were unaware a Federal requirement existed and filed returns resulting in ATF collections of more than $15,800. While this program was successful, it was directed at new dealers who could be ignorant of tax requirements. This could have been a significant factor in the high response rate received by ATF.

In ATF's Midwest region, each State was requested to provide ATF a list of retail dealers whom State inspectors believed were not obtaining a Federal occupational tax stamp. Only 2 States cooperated and 541 form letters were mailed to the potentially delinquent taxpayers informing them of their responsibility to pay the tax. Responses were received from 297 retail dealers, of which 84 made voluntary payments and 213 replied that they had already paid the tax. ATF inspectors attempted to personally contact those not responding, but the effort was stopped when 16 of 19 retail dealers visited had valid tax stamps.

These experiments show that State-supplied data can be useful in collecting occupational taxes. It does not provide the means of identifying all delinquents in all States, nor does it obviate the need for additional ATF manpower if compliance with occupational tax laws is to be significantly improved.

INFORM RETAILERS OF THEIR OCCUPATIONAL TAX OBLIGATION THROUGH STATES

Of the 174 retail dealers shown to be delinquent by our random sample in California, Georgia, Illinois, and Ohio, 113, or 65 percent, stated that they were unaware of their obligation to pay occupational taxes. It can be assumed, therefore, that many of the projected 24,000 to 33,500 delinquent taxpayers in the 4 States also are unaware of their responsibilities in this area. However, persons found violating the law often plead ignorance of its provisions.

ATF has made some efforts to notify retail dealers of their occupational tax obligations. For example, in 1974 the central region began using mailing lists of State licensees to distribute occupational tax literature to retail dealers in Ohio and Kentucky. In the southeast region the Georgia liquor control agency, at ATF's request, included occupational tax literature with each license renewal application. These approaches, however, can be used only where ATF and State relations are good and where State data is available.

AMNESTY PERIOD FOR DELINQUENT TAXPAYERS

ATF has proposed an amnesty period for delinquent occupational taxpayers. The program, submitted in October 1974 for Treasury Department approval, provides for a 90-day period during which retail dealers may voluntarily pay delinquent occupational taxes, plus interest, without being assessed the usual penalties.

An amnesty period may or may not yield results. The fact that substantial amounts and penalties are not involved would seem to make amnesty less interesting to the delinquent. Also, many delinquents are not even aware that they owe the tax. In any event, amnesty does not offer a long-term solution to the collection problem.

We understand there may be other obstacles. The Treasury's General Counsel has returned the proposal to ATF with a recommendation that ATF's Chief Counsel research the United States Code to support such a recommendation.

CHAPTER 5

RELATIONSHIP BETWEEN THE OCCUPATIONAL TAX LAWS AND THE FEDERAL ALCOHOL ADMINISTRATION ACT

In the course of our review, we discovered that ATF was relying upon its authority under the occupational tax laws to enter the premises of retailers and wholesalers in distilled spirits, beer, and/or wine, to enforce another law, the Federal Alcohol Administration Act. We felt it necessary, therefore, to explore this relationship.

FEDERAL ALCOHOL ADMINISTRATION ACT REQUIREMENTS

The Federal Alcohol Administration Act was passed in 1935 because the Congress believed that Federal regulation of the alcohol industry was needed to protect the public and the revenue. Specifically, the act regulates the furnishing of inducements to retailers in alcoholic beverages that result in the exclusion of competitors' products; prohibits the establishment of exclusive outlets wherein a retailer is required to sell a particular brand of, or a company's, distilled spirits, beer, or wine to the exclusion of competitors' products; prohibits consignment or conditional sales; prohibits false advertising and labeling of beer, distilled spirits, and wine; regulates the number of operators in bulk sales and bottling of distilled spirits; and regulates nonindustrial use of distilled spirits and wine.

The act also requires manufacturers of distilled spirits and wine; importers and wholesalers of beer, distilled spirits, and wine; rectifiers; and bottlers and warehousers of distilled spirits to obtain a Federal permit to operate. This permit can be obtained free of charge upon application to ATF but is conditioned upon compliance with all Federal laws governing the alcohol industry.

Many violations of the act involve unfair trade practices, such as wholesalers inducing retailers to sell their products to the exclusion of competitors' products. Inducements may take the form of free equipment, such as beer refrigerators, cash discounts, or rebates; and violators are often identified from tips or allegations by other industry members. For example, a wholesaler may complain that a competitor is providing free beer refrigerators to retail dealers in return for a promise that the retailers will carry the competitor's brand to the exclusion of the complainant's products.

Trade practice investigations normally involve interviewing wholesalers and their employees; examining wholesalers' ownership records, sales invoices, inventory records, canceled checks, bank statements, and salesmen's expense ledgers; and followup at the premises of retail dealers who do business with the accused wholesaler. Since retail dealers are not required to have a permit, ATF has used its authority under 26 U.S.C. 5146(b) to enter a retailer's premises to inspect occupational tax and related records required to be kept under the Internal Revenue Code. When the inspector gains entrance to a retailer's premises, purchase invoices are reviewed and the dealer and his employees are asked if prohibited trade practices exist. During this review a determination will be made as to whether the retailer has a valid occupational tax stamp.

If consumer or trade practice violations are disclosed by the investigation, ATF settles the violation by either imposing a fine or suspending--normally for 3 days--or revoking the offending wholesaler's permit. No action is taken against retailers who participated in these activities since they are not subject to the FAA Act. If permit action is taken, the permittee is issued a citation (order to show cause) which describes the alleged violation and provides for a hearing in which the permittee will be given an opportunity to show cause why his permit should not be suspended or revoked. The hearing is presided over by a Treasury Department administrative law judge, who determines whether the permit should be suspended or revoked.

ATF INVESTIGATIVE TECHNIQUES

To determine the investigative methods employed by ATF inspectors to gather evidence of FAA Act violations at the premises of wholesalers and retailers, we participated to a limited degree in two trade practice investigations as observers. The two investigations were conducted by 11 ATF inspectors and involved contacts with 5 wholesale and 51 retail dealers. We observed inspections at the premises of 4 wholesale and 15 retail dealers.

ATF initiated both investigations on the basis of allegations by third parties that unfair trade practices were being committed. One allegation indicated that beer wholesalers were providing cash rebates to retail dealers. The second allegation accused a wholesale liquor dealer of providing cash rebates to induce retail dealers to increase their purchases of his brand of distilled spirits.

ATF inspectors entered the premises of both wholesalers and retailers to examine ownership records (wholesalers only),

tax data, and/or inventory records. In most instances, the inspector informed the dealer that trade practices were also under scrutiny.

At each wholesaler's premises, ATF inspectors first examined ownership and permit records and verified payment of occupational taxes. Other records reviewed included purchase and sales invoices, salesmen's expense ledgers, canceled checks, business bank statements, and other business ledgers and records. The records were reviewed for indications of prohibited trade practices, such as notes or instructions on invoices describing "deals," sudden increases in a retailer's purchases, and purchases of apparently unneeded refrigeration and other equipment used by retailers. In addition, the wholesalers were questioned about area trade practices.

In every instance the wholesalers cooperated fully with ATF. None denied the inspector access to records or refused to discuss area trade practices. ATF spent 231 staff-days at these wholesalers' premises during the two investigations.

After completing their data collection activities at the wholesalers' premises, ATF inspectors visited selected retailers whose purchases from wholesalers suspected of unfair trade practices appeared questionable. Upon entering a retailer's premises, ATF inspectors identified themselves as Treasury agents, asked to see the current occupational tax stamp, and examined purchase invoices and records for approximately a 1-year period. The inspectors advised the retailer that area trade practices were being investigated and questioned the retailer on the extent of his participation in such practices. The inspector also asked if the retailer would be willing to put his statement in the form of an affidavit.

In its investigations, ATF found that nine retailers had received free equipment and other inducements from various beer wholesalers and had taken action to exclude the products of these wholesalers' competitors. A typical example was an agreement under which a refrigerator valued at $1,500 was sold to a retailer at a 50-percent discount in exchange for a promise to promote the wholesaler's products to the exclusion of competitive brands. Further, nine of the retail dealers were delinquent in 1 or more years of their occupational tax obligations. Over $700 in tax, interest, and penalties was collected.

ATF has no recourse against the retailers who received free equipment since the FAA Act does not require them to obtain a permit. However, information obtained from retailers

may be used against the offending wholesalers. ATF is preparing the necessary papers for a permit hearing at which offending beer wholesalers will be required to show why their permits should not be suspended or revoked. The liquor wholesaler investigation is continuing but has been hampered by a lack of manpower.

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Searching for violations of the FAA Act under the pretext of enforcing the occupational tax laws is a questionable practice. It is discussed at some length in the next chapter, which first presents our general conclusions on the occupational tax laws and then discusses FAA Act enforcement.

CHAPTER 6

MATTERS FOR CONSIDERATION BY THE CONGRESS

The 27-percent delinquency rate found in our sample of retail dealers in alcoholic beverages indicates that occupational tax compliance has dropped below acceptable levels and enforcement is not adequate. Furthermore, this has been a longstanding problem. Under these circumstances, first thoughts are naturally directed to the possibility of more effective enforcement techniques and the need for increased manpower.

Although there may be some opportunity for improving enforcement techniques, we do not foresee any new or innovative approach that will, of itself, reverse the situation. There remains, then, the question of whether deployment of additional manpower to enforce collection of the occupational taxes is in order. Increased enforcement would provide the usual basic benefits, i.e., increased revenues, equitable treatment of taxpayers, respect for the law, and voluntary compliance.

However, given the general characteristics of the occupational taxes, the overriding question is not whether there should be increased enforcement but whether the tax itself ought to be continued. Occupational taxes:

--Are no longer a significant revenue source.

--Are inherently inefficient to collect because they involve the direct collection of small amounts from a relatively large number of taxpayers.

--Require separate administrative machinery for the Government and impose additional paperwork on the taxpayer.

--Are overshadowed by Federal excise taxes on alcoholic beverages, which produce much more revenue and are more efficiently collected.

--Are paralleled by State and local license fees; these governments perform a regulatory function which the Federal Government does not.

On balance, repealing the occupational taxes appears preferable to increased enforcement. The lost revenue of $18.6 million could be recouped, if desired, by an almost

infinitesimal increase in the excise tax on alcohol--which would not only avoid the need for any increase in enforcement costs for occupational taxes but would eliminate such costs altogether. For example, a 6- to 7-cent increase in the $10.50 per gallon excise tax on distilled spirits would accomplish this.

ENFORCEMENT OF THE FAA ACT

We have come to the foregoing conclusion notwithstanding the fact that ATF has relied upon the occupational tax laws as authority to enter the premises of wholesale and retail dealers to investigate violations of another law, the FAA Act.

ATF is authorized by 26 U.S.C. 5146(b), as the delegate of the Secretary of the Treasury, to enter the premises of wholesalers and retailers to inspect occupational tax records required by chapter 51 of the Internal Revenue Code of 1954. At present, the ATF manual also refers to this section of law as its authority to enter the premises of retail dealers to gather evidence of FAA Act violations.

We do not question ATF's authority under 26 U.S.C. 5146(b) to enter the premises and inspect records of wholesale and retail dealers for purposes related to chapter 51 of the Internal Revenue Code of 1954. Furthermore, when lawfully engaged in an inspection under this section of the law, it is only reasonable that ATF inspectors seize evidence of other illegal or unlawful conduct inadvertently discovered.

We believe, however, that this inspection authority may not be used to gather evidence of violations of other laws, such as the FAA Act, when a primary purpose of the inspection is to discover such evidence.

Although ATF inspectors routinely check occupational tax records during these inspections, the discovery of FAA Act violations is neither inadvertent nor unexpected. Our review of ATF's efforts to enforce the FAA Act indicated that a primary purpose of many inspections at the premises of wholesalers and retailers is to search for evidence of FAA Act violations. We have serious reservations, therefore, that 26 U.S.C. 5146(b) provides an adequate legal basis for such an investigative practice.

If 26 U.S.C. 5146(b) is subject to limitations, what authority, then, can ATF rely upon to enforce the FAA Act? The most logical source of authority for ATF's investigative

practice is the FAA Act. The act, however, does not contain a provision expressly authorizing ATF to engage in investigations of specific violations; and in the only court test of ATF's implied authority to investigate violations under the act, it was concluded that the FAA Act does not authorize investigations for violations except when the investigation is conducted in connection with a permit hearing.

In Serr v. Sullivan, 270 F. Supp. 544 (E.D. Pa. 1967), aff'd, 390 F. 2d 619 (3d Cir. 1968), the Director of ATF petitioned the court, prior to the initiation of a permit hearing, to compel certain persons suspected of having violated the FAA Act to appear and testify according to the terms of a subpoena duces tecum. The court denied the petition, concluding that investigations to uncover violations of the FAA Act are authorized only when conducted in the context of a permit hearing. The court reasoned that (1) unlike similar statutes, the FAA Act did not specifically grant investigative authority, (2) the act's legislative history indicated that the Congress rejected a provision authorizing investigations, and (3) the Congress chose the permit hearing as the means of administering and enforcing the act.

Applying the rationale of Serr v. Sullivan, it appears that ATF's practice of entering the premises of wholesale and retail dealers, inspecting records, and inquiring about area trade practices is not authorized by the FAA Act. While permit revocation or suspension hearings may result from evidence discovered during investigations at the premises of wholesalers and retailers, ATF engages in these investigations prior to, and outside of the context of, a permit hearing.

Serr v. Sullivan is the only court decision that has tested the nature and extent of ATF's investigative authority under the FAA Act. In response to our inquiry, however, ATF informed us that, after initially acquiescing in the Serr decision, it believed that the court's interpretation was incorrect and considered the decision binding only in the Third Circuit. Furthermore, in a memorandum of law provided to us, ATF presented several arguments challenging the court's reasoning and supporting its contention that the power to investigate specific violations of the FAA Act should be implied in the act. An amendment to the ATF manual is being prepared to reflect ATF's views.

In the memorandum of law provided to us, ATF pointed out the practical difficulties created by the Serr decision. As interpreted in Serr, a permit hearing must be initiated

before an investigation may be conducted under the act. Normally, however, investigation precedes formal administrative adjudication. In fact, the procedural formalities surrounding a permit revocation or suspension hearing under the FAA Act practically require that some investigation be conducted before hearing procedures are begun.

For example, accepted norms of fundamental fairness require that, before a Government agency takes action adversely affecting an individual's business or livelihood, the agency must give the individual notice of the reasons for its action and an opportunity for a hearing. Similarly, under ATF's regulations, persons entitled to a permit revocation or suspension hearing must be notified in writing of the specific violation of the FAA Act, including dates, places, and sections of the law violated. The Director of ATF, however, cannot be expected to give the required notice without first conducting a preliminary investigation.

In short, the Serr v. Sullivan decision renders the FAA Act difficult, if not impossible, to enforce. To investigate specific violations, it seems that ATF first must initiate a permit hearing, an impracticable and administratively burdensome procedure. Alternatively, ATF may rely on the inadvertent discovery of evidence of FAA Act violations while making other inspections authorized by the Internal Revenue Code. Neither procedure, however, allows ATF to make the type of investigations required for effective enforcement of the FAA Act. Thus the legal authority of ATF to investigate violations of the FAA Act may be inadequate.

We believe that ATF's legal authority to investigate potential violations of the FAA Act needs to be clarified by the Congress. The FAA Act should be amended to authorize ATF to investigate specific violations before initiating a permit hearing. Although ATF's practice of investigating potential violations at the premises of wholesale and retail dealers is a reasonable and appropriate method of enforcing the act, the court's rationale in Serr v. Sullivan casts serious doubt on whether the practice is authorized under existing law and whether ATF has adequate authority to enforce the act effectively.

As stated earlier, except in the Third Circuit, ATF intends to continue to gather evidence of FAA Act violations at the premises of wholesalers and retailers before permit hearings. As a result, ATF may encounter additional legal challenges to its investigative authority based upon the Serr decision. Such litigation would increase costs to the taxpayers and prolong active investigations. Furthermore,

judicial resolution of the problem seems inappropriate since neither the act nor the legislative history clearly shows how the Congress intended the act to be enforced. Thus, other courts may well reach the same conclusion as that in Serr v. Sullivan.

AGENCY COMMENTS

ATF opposes the repeal of occupational taxes on the basis that:

--The $18.6 million collected in fiscal year 1974, which represents 18 percent of the Bureau's total operating budget, is not insignificant.

--The occupational tax revenue represents voluntary payments for which the cost of collection is relatively low.

--Elimination of the tax will result in the loss of a valuable criminal enforcement tool and, at the same time, make it easier for an undesirable element to operate at the retail level.

ATF agrees that the FAA Act should be amended to clarify the Bureau's authority to make investigations and also acknowledges that expressed statutory investigative authority is more desirable than implied authority. However, the Bureau favors an approach whereby its implied investigative authority would be tested in at least two other circuits before attempts are made to secure amending legislation.

Appendix I contains the full text of ATF's comments on this report together with appropriate GAO rebuttals.

RECOMMENDATION

We recommend that the Congress:

--Repeal all occupational taxes in sections 5081 through 5148 of the Internal Revenue Code on retail and wholesale dealers in distilled spirits, wines, and beer; manufacturers of nonbeverage alcoholic products; brewers; manufacturers of stills; and rectifiers.

--Amend the Federal Alcohol Administration Act to clarify the authority of the Bureau of Alcohol, Tobacco and Firearms to investigate possible consumer and/or unfair trade practice violations of the act prior to a permit hearing.

CHAPTER 7

SCOPE OF REVIEW

Our review of ATF's enforcement of the alcohol-related occupational tax laws was conducted at the ATF national office, Washington, D.C., and at regional offices in Atlanta, Cincinnati, Chicago, and San Francisco. We examined policies, procedures, and directives governing the collection of delinquent occupational taxes; reviewed ATF surveys and studies of the delinquency problem with retail dealers; examined original legislation and related hearings which established the occupational tax laws; and analyzed occupational tax collection statistics from 1870 to 1974.

Delinquency data was obtained on a random sample basis through personal contact with retail dealers in California, Georgia, Illinois, and Ohio. Both regional and national ATF officials, as well as officials of various State liquor control agencies, were interviewed.

The review of ATF's investigatory activities under the Federal Alcohol Administration Act was performed in the locations in which occupational tax work was undertaken--Atlanta excepted. We reviewed the act's legislative history, examined ATF procedures, and interviewed agency officials. We also examined numerous ATF investigation reports and accompanied ATF inspectors on several investigations.

APPENDIX I

This appendix contains the response of the Director, Bureau of Alcohol, Tobacco and Firearms, to our report. Our comments on certain statements made by the Director appear in italics immediately after the statement in question.

APPENDIX I

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

October 21, 1975

Mr Victor L. Lowe
Director, General Government Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Lowe:

This refers to your letter of September 9, 1975, which forwarded for our review and comment a draft of a proposed report to the Joint Committee on Internal Revenue Taxation relative to the Repeal of Occupational Taxes on the Alcohol Industry; and Amending the Federal Alcohol Administration Act.

We appreciate the opportunity to comment on your report. The Bureau agrees with the GAO recommendation that the Federal Alcohol Administration Act be amended to clarify the authority of the Bureau of Alcohol, Tobacco and Firearms to conduct investigations of violations under that Act; however, the Bureau does oppose the repeal of the occupational taxes in §§5081-5148 of the Internal Revenue Code.

Our comments and suggestions to the two specific recommendations contained in the report are presented below.

RECOMMENDATION NO. 1

That Congress consider the repeal of occupational taxes contained in IRC 5081-5148 on retail dealers in distilled spirits, wines, and beer; wholesale dealers in distilled spirits, wines, and beer; manufacturers of nonbeverage alcoholic products; brewers; manufacturers of stills; and rectifiers.

APPENDIX I

Mr. Victor L. Lowe
Director, General Government Division

We have been aware for several years that taxpayer compliance with special occupational tax laws at the retail level has been steadily decreasing. As the report states, we have attempted unsuccessfully to secure adequate staffing to insure a satisfactory level of compliance. While individual regions initiated certain isolated and innovative approaches to collecting these taxes and securing greater compliance, they simply lacked sufficient manpower to do a complete job.

However, while we agree compliance is low, we disagree that the $18.6 million collected in FY 74 is such an insignificant amount that, when coupled with high administrative costs for collection and assuring compliance, the tax should be abolished.

First, while the $18.6 million is small in relation to the approximately $269 billion in revenue collected by the Federal Government, we do not consider a sum which represents approximately 18% of our total operating budget as insignificant. It should also be kept in mind that the above occupational tax revenues represent voluntary payments for which the cost of collection is relatively low.

[*GAO comment: The relationship between occupational tax revenues and the ATF budget seems irrelevant.*

Also, the cost of collecting occupational taxes will not be "relatively low" if a reasonable level of compliance is required.

For comparison, IRS collection costs amount to only $.005 per revenue dollar for income, estate and gift, employment, and excise taxes, which include the aforementioned occupational taxes.

Using this criteria, we estimate that not more than 8 staff-years of inspection effort could be economically expended by ATF in collecting occupational taxes without exceeding the established IRS cost of collecting a revenue dollar.

We don't believe that compliance with occupational taxes can be brought up to a reasonable level with as little as 8 staff-years.]

APPENDIX I

The report indicates that increased enforcement effort to collect an additional $2-4 million in delinquent taxes would not be cost effective. While there are a number of alternatives for increasing compliance available to us, e.g. increased publicity, improved liaison with states and retail associations, and greater enforcement effort (both field and office), more information is needed on which to reach an informed decision. To test the relative effectiveness of the above and other alternatives, we could initiate a pilot project in one or more large metropolitan areas. By accumulating data and analyzing results, we would be better able to make a sound decision as to the cost effectiveness of collecting delinquent special taxes.

[illegible]

The report does not address the adverse effect elimination of special occupational taxes would have on our efforts in combatting organized crime. The failure of many organized crime figures to disclose their financial interest in retail liquor establishments when preparing an application, Form 11, for the special tax stamp has enabled the Bureau to make a number of "hidden ownership" cases against significant OCC members and associates. If the special occupational tax is eliminated, we will lose a valuable enforcement tool and at the same time make it easier for an undesirable element to operate at the retail level. Should this happen the possibility exists that such elements would in the future intensify their efforts to infiltrate the wholesale level.

[illegible]

Mr. Victor L. Lowe
Director, General Government Division

Finally, we do not agree that increasing the present excise tax on distilled spirits from $10.50 per gallon to $10.56 per gallon is a desirable, practical alternative for offsetting the expected loss of revenue. Any increase in tax would inevitably be passed along to the consumer, a questionable move in these inflationary times. It should also be noted that a 6 cent a gallon increase in taxes would result in increases greater than 6 cents by the time they reached the consumer because many states provide for mandatory mark-ups at the retail level, such mark-ups based on the price charged the retailer by a wholesaler.

We further question the consistency of recommending on the one hand that special occupational taxes be eliminated because they are relatively insignificant as a revenue source and then suggesting on the other hand that excise taxes be raised to recoup the lost revenue. If the occupational taxes are truly insignificant (a point with which we disagree), then recouping the lost revenue would not seem an important consideration. If, however, the revenue is important, it seems far easier and more acceptable in the eyes of the affected industry to retain the present tax rather than attempt to increase an existing excise tax.

[GAO comment: The alternative of an infinitesimal increase in the excise tax on distilled spirits was only presented to show the inefficiency of maintaining the separate occupational tax structure. As to the impact on the consumer, we expect that occupational taxes are passed along too.]

RECOMMENDATION NO. 2

That Congress consider amending the Federal Alcohol Administration Act to authorize ATF to conduct investigations of possible violations of the Act prior to a permit hearing.

As referenced in the attached report, we now feel that the limitations placed on our efforts to enforce the FAA Act in Serr v. Sullivan are binding only in the Third Circuit and also that the court incorrectly interpreted the Act. Our field personnel have been so advised and are now conducting investigations at wholesale and retail premises outside the Third Circuit under implied investigative powers in the Act. While we have been alert for any challenges to our authority so that we might test our implied powers assertion in another circuit, so far we have not encountered any such challenges.

Since the problem still exists in the Third Circuit, however, and since expressed statutory investigative authority is more desirable than implied authority, we would agree with your recommendation that the FAA Act be amended to clarify our authority to make investigations under the Act.

APPENDIX I

Mr. Victor L. Lowe
Director, General Government Division

We believe it might be better to test our implied authority in other circuits prior to seeking amending legislation. If we were successful, legislative change would not be necessary. If unsuccessful, a much more persuasive argument would seem to exist for securing amended legislation.

[*GAO comment: We believe that the Congress, rather than the courts, should clarify ATF's investigative authority under the FAA Act because: (1) wholesale and retail liquor dealers may be reluctant to challenge ATF's assertion of authority due to the costs of protracted litigation; (2) an agency's investigative authority should be subject to specifically defined limitations and the Congress is best equipped to formulate these limitations since courts must proceed on a case-by-case basis; and (3) there is a good probability that, after years of litigation, other courts may reach the same conclusion as* Serr *v.* Sullivan.*]*

To summarize, it is the Bureau's position:

1. That the special occupational taxes be retained as they result in the collection of approximately $18.6 million with relatively little administrative expense and even less enforcement effort. To assist in a determination as to the cost effectiveness of increasing our enforcement efforts to collect delinquent taxes, we feel a pilot program in one or more metropolitan areas would provide more meaningful information.

2. That our assertion of implied investigative authority under the FAA Act be tested in at least two other circuits before attempts are made to secure amended legislation to clarify our authority.

We appreciate the high degree of professionalism exhibited by your staff members assigned to the audit and for the additional insight into the above two program areas.

Sincerely yours,

Rex D. Davis

GAO note: We have deleted from this letter a comment by ATF on the sensitivity of certain information presented in the draft. ATF advised us that it wished to withdraw the comment.

PRINCIPAL OFFICIALS RESPONSIBLE FOR ADMINISTERING ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
SECRETARY OF THE TREASURY:		
William E. Simon	May 1974	Present
George P. Shultz	June 1972	May 1974
John B. Connally	Feb. 1971	June 1972
COMMISSIONER OF INTERNAL REVENUE:		
Donald C. Alexander	May 1973	Present
Raymond F. Harless (acting)	May 1973	May 1973
Johnnie M. Walters	Aug. 1971	Apr. 1973
Harold T. Swartz (acting)	June 1971	Aug. 1971
DIRECTOR, BUREAU OF ALCOHOL, TOBACCO AND FIREARMS:		
Rex D. Davis	Sept. 1972	Present
Rex D. Davis (acting) (note a)	July 1972	Sept. 1972
Rex D. Davis	Mar. 1971	July 1972
ASSISTANT DIRECTOR, REGULATORY ENFORCEMENT:		
Stephen E. Higgins	Apr. 1975	Present
Stephen E. Higgins (acting)	Mar. 1975	Apr. 1975
Ora J. Pierce (acting)	Jan. 1975	Mar. 1975
Lawrence S. Carlson	Nov. 1972	Dec. 1974
Lawrence S. Carlson (acting)	Dec. 1971	Nov. 1972

a/Effective July 1, 1972, the Alcohol, Tobacco and Firearms Division, Internal Revenue Service was redesignated the Bureau of Alcohol, Tobacco and Firearms by Treasury Department Order 221.