



*Excise Tax Registrations Are Not Always
Timely or Accurately Processed*

September 9, 2019

Reference Number: 2019-40-079

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

Phone Number / 202-622-6500

E-mail Address / TIGTACommunications@tigta.treas.gov

Website / <http://www.treasury.gov/tigta>



To report fraud, waste, or abuse, call our toll-free hotline at:

1-800-366-4484

By Web:

www.treasury.gov/tigta/

Or Write:

Treasury Inspector General for Tax Administration
P.O. Box 589
Ben Franklin Station
Washington, D.C. 20044-0589

Information you provide is confidential and you may remain anonymous.



HIGHLIGHTS

EXCISE TAX REGISTRATIONS ARE NOT ALWAYS TIMELY OR ACCURATELY PROCESSED

Highlights

Final Report issued on
September 9, 2019

Highlights of Reference Number: 2019-40-079
to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

The Federal Government levies excise taxes to finance general Government activities and specific programs. Excise taxes are assessed on the sale, use, or inventory of various goods, services, or activities. The taxes may be imposed at the time of the sale by the manufacturer or retailer or when used by the consumer. There are a total of 59 excise taxes administered by the IRS.

WHY TIGTA DID THE AUDIT

This audit was initiated to evaluate the IRS's excise tax registration program. Businesses engaging in certain excise tax activities must be registered with the IRS prior to engaging in that activity. Once a registration is approved, businesses must also meet specific tax compliance requirements or their registration will be revoked or suspended.

WHAT TIGTA FOUND

TIGTA's review of a statistically valid sample of 133 Forms 637, *Application for Registration (For Certain Excise Tax Activities)*, received during January 1, 2017, through September 30, 2018, found that 44 (33 percent) of the applications were not processed timely by IRS tax examiners.

In addition, TIGTA's review of the tax accounts associated with 6,637 excise tax registrants approved in Fiscal Year 2018 identified 2,395 unique businesses that were not compliant with one or more of the conditions requiring the mailing of a Letter 3696, *Results of 637 Compliance Review*. The IRS reviewed a judgmental sample of 212 cases. For six of the

cases, management noted that a Letter 3696 was not issued when in fact one should have been. In another six cases for which a letter was not sent, IRS management noted that the excise tax noncompliance issue was addressed by a tax examiner or a revenue agent as part of contact with the business on a different matter. For the remaining 200 cases, management provided sufficient documentation or explanation to support actions taken to address the noncompliance.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division, develop processes and procedures to ensure that that Letter 3681, *637 Notification Letter*, is mailed within the five days of case assignment and that compliance reviews are conducted within the required 60 days; develop processes and procedures to ensure that tax accounts of currently and newly approved businesses include the required Form 637 indicator; and develop processes and procedures to ensure that Letter 3696 is sent when required or case files are notated as to the reason why a letter is not being sent.

IRS management agreed with all the recommendations and plans to take the appropriate corrective actions to develop and update procedures.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 9, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM:

Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Excise Tax Registrations Are Not Always Timely
or Accurately Processed (Audit # 201840011)

This report presents the results of our review to evaluate the Internal Revenue Service's (IRS) excise tax registration program. This review is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Improving Tax Reporting and Payment Compliance.

Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services).



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Table of Contents

<u>Background</u>	Page 1
<u>Results of Review</u>	Page 4
<u>Tax Examiners Are Not Always Timely and Accurately Processing Excise Tax Registration Applications</u>	Page 4
<u>Recommendations 1 through 3:</u>	Page 7
 Appendices	
<u>Appendix I – Detailed Objective, Scope, and Methodology</u>	Page 8
<u>Appendix II – Major Contributors to This Report</u>	Page 11
<u>Appendix III – Report Distribution List</u>	Page 12
<u>Appendix IV – Outcome Measures</u>	Page 13
<u>Appendix V – Form 637, Application for Registration (For Certain Excise Tax Activities), Activity Letters and Descriptions</u>	Page 15
<u>Appendix VI – Management’s Response to the Draft Report</u>	Page 18



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Background

The Federal Government levies excise taxes to finance general Government activities and specific programs. Specifically, excise taxes are assessed on the sale, use, or inventory of various types of goods, services, and activities. Excise taxes may be imposed at the time of the sale by the manufacturer or retailer or when used by the consumer. As of September 2018, there are a total of 59 excise taxes administered by the Internal Revenue Service (IRS).

Authority to require businesses to register with the IRS

Internal Revenue Code Sections 4101 (Fuel Taxes), 4222 (Retailers and Manufactures Excise Taxes), and 4682 (Ozone-Depleting Chemicals Tax) and Treasury Regulation Section 48.4101-1 provides the IRS with the authority to require businesses to register with the IRS before engaging in certain excise activities. Under the Internal Revenue Code and regulations, each business that engages in certain specified excise tax–related activities must be registered by the IRS before engaging in that activity. Some businesses are required to be registered by the IRS to receive an excise tax benefit, such as the right to sell or buy an article tax-free or at a reduced tax rate or to file a claim, whereas other businesses are required to register in order to conduct business with other registrants (*i.e.*, businesses).

Excise tax registration process

Taxpayers must meet certain standards in order to receive and retain a registration. The registration process allows the IRS to determine if those standards are met and to monitor and identify taxpayers engaged in certain activities or making certain transactions. These standards vary according to the activity involved and include, for example, the requirement to file tax returns.

To register with the IRS, applicants mail or fax Form 637, *Application for Registration (For Certain Excise Tax Activities)*, to the Excise Operations Unit in Cincinnati, Ohio. The current Form 637 contains 27 different excise tax activity letters¹ that coincide with the specific activities in which a business intends to engage. For businesses engaging in excise tax activities, each Employer Identification Number, regardless of relationship (*e.g.*, parent and subsidiary businesses), must apply for its own excise tax registration number on Form 637.

¹ Excise tax activities are assigned an alphanumeric code listed on pages 2 through 4 of Form 637. Several excise taxes may fall under one activity letter. For example, manufacturers of gas-guzzler automobiles, sport fishing equipment (including fishing rods and fishing poles), fishing tackle boxes, bows, quivers, broadheads, points, arrow shafts, taxable tires, taxable medical devices, or vaccines fall under Activity Letter “A” but constitute several different excise taxes. See Appendix V for Form 637 activity letters and descriptions.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Process for reviewing/approving excise tax registration applications

Upon receipt of Form 637, the Tax Processing Center date stamps and forwards the applications to the Centralized Specialty Tax Operations team for initial processing, which will verify the business's information (*e.g.*, business name, Employer Identification Number, *etc.*) against the IRS's records. The team then enters Form 637, Part I, entity information into a case management system called the Issue Management System, which stores excise tax application and registration data. Figure 1 is an excerpt of Form 637, Part I:

Figure 1: Form 637, Part I

Form 637 (Rev. October 2017) Department of the Treasury Internal Revenue Service	Application for Registration (For Certain Excise Tax Activities) ▶ Go to www.irs.gov/Form637 for the latest information.	OMB No. 1545-0014
Part I Identification of Applicant		
Type or print	Legal name of entity (or individual) for which the employer identification number (EIN) was secured	Employer identification number (EIN)
	Trade name of business if different from above	Telephone number
	Mailing address (number, street, and room or suite no.; if P.O. box, see instructions)	Fax number
	City or town, state or province, country, and ZIP or foreign postal code	
	If you listed a P.O. box above, or if your street address is different from your mailing address, list your street address (including city or town, state or province, country, and ZIP or foreign postal code)	

Source: Excerpt of Form 637 found on IRS.gov.

Once the above is completed, a copy of the Form 637 is scanned and uploaded into the Issue Management System, the original Form 637 application is mailed to the Excise Registration Group, and the application is assigned to a tax examiner. Once assigned, the tax examiner prepares and mails Letter 3681, *637 Notification Letter*, to the applicant within five days of assignment. Letter 3681 informs the applicant that the IRS has received the application and it is being processed. The tax examiner also performs a compliance review on the business that is applying and its related parties. The compliance review includes conducting research of the business applying for the excise tax benefit and its related parties (*e.g.*, owners, officers, members, *etc.*) to determine filing, deposit, and payment history. Tax examiners have up to 60 days to complete the compliance review.

In addition to the compliance review, the tax examiner will research the IRS's Integrated Data Retrieval System² to verify the information on the application and to determine if the taxpayer filed all required tax returns or has any outstanding balances due, *etc.* Once this initial review is complete, the Lead Technician will determine whether the application process will be completed in the Excise Registration Group or will be assigned to a designated Excise Tax Field Group for

² IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

a revenue agent to complete. Applications assigned to a revenue agent are those that involve more complex activities on the part of the business. As such, a revenue agent must complete the processing of applications meeting those criteria.

The IRS issues Letter 3689, *Approval of Excise Tax Registration*, to notify a business that its application is approved. Letter 3689 includes the assigned excise tax registration number, the activities the business was approved for, and the effective date of the registration. If the application is denied, the IRS will send Letter 3685, *Denial of Excise Tax Registration*, to the business stating the reason for the denial. Letter 3685 instructs businesses that wish to appeal a denial of registration to state their position in writing and send it back to the Excise Registration Group within 10 days of the date of the letter. The Excise Registration Group will review the appeal and, if it is denied, Letter 3684, *Denial of Appeal for Registration*, will be issued to the taxpayer. The Chief, Estate and Gift Tax and Excise Examination, makes the final determination on appeals of all denials, revocations, or suspensions. The IRS reported receiving 5,457 Forms 637 during Fiscal Year³ 2018 processing.

This review was performed in the IRS's Small Business/Self-Employed Division, Specialty Exam/Excise Tax Policy and Technology Solutions Groups at the Covington, Kentucky; Houston, Texas; and Ogden, Utah, offices during the period May 2018 through June 2019. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

³ A fiscal year is any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Results of Review

**Tax Examiners Are Not Always Timely and Accurately Processing
Excise Tax Registration Applications**

Our review of a statistically valid sample of 133 Form 637 applications⁴ (69 approved and 64 denied) received during October 1, 2017, through September 30, 2018, found that some applications were not timely and/or accurately processed. For example:

- 44 (33 percent) applications were not timely processed by the IRS. Based on the results of our statistically valid sample, we estimate that 424 cases⁵ were potentially not timely processed. The errors associated with the 44 cases included:
 - For 32 (73 percent) of the 44 cases, the tax examiner did not complete the compliance review within the required 60 days. For these 32 cases, compliance reviews took an average of 80 days, with specific time frames ranging from 62 to 165 days. *****1*****
*****1*****
*****1*****
Internal guidelines state that all initial Form 637 applications must be reviewed for compliance within 60 days of the case being assigned. When we discussed these results with IRS management, they cited resource limitations as the reason for the delays.
 - For 12 (27 percent) of the 44 cases, the tax examiner did not mail Letter 3681, *637 Notification Letter*, within the required time frame. For the 12 cases, Letters 3681 were sent within an average of 34 days after assignment, with specific time frames ranging from 12 to 122 days. Internal guidelines state that Letter 3681 must be prepared and mailed to all initial applicants within five calendar days from the date the case is assigned to a tax examiner in the Issue Management System. Prior to July 17, 2018, guidelines required Letter 3681 to be mailed within 20 calendar days from the date the case file was created. When we discussed these results with IRS management, they cited resource concerns as the reason for the delays.

In addition, for nine (13 percent) applications, the IRS did not accurately update the business tax account with the required Form 637 indicator. Based on the results of our statistically valid

⁴ Our sample was selected using a 95 percent confidence interval, 5 percent error rate, and ± 5 percent precision factor.

⁵ When projecting the results of our statistical sample, we are 95 percent confident that the actual total amount is between 315 and 533 (where the 315 and 533 represent the lower and upper range, respectively).



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

sample, we estimate that 127 taxpayer accounts⁶ were not updated with the Form 637 indicator as required. If the Form 637 indicator does not post to the entity module, the IRS cannot systemically monitor and identify businesses that are not compliant with registration conditions. When we discussed these results with IRS management, they stated tax examiners were not submitting Form 2363, *Master File Entity Change*, to add the indicator to the IRS's Integrated Data Retrieval System. Subsequent to our bringing this to the IRS's attention, management took action and added the Form 637 indicators to nine the accounts we identified.

Improvements are needed to ensure that Letter 3696, Results of 637 Compliance Review, is mailed when required or case files are documented with reason the required letter was not sent

Our review of the tax accounts associated with 6,637 approved Fiscal Year 2018 excise tax registrants⁷ identified 2,395 unique businesses that were not compliant with one or more of the conditions requiring the mailing of a Letter 3696. However, we were unable to determine whether a Letter 3696 was in fact sent to these 2,395 businesses because processes did not ensure that case files were adequately documented to reflect the mailing of a Letter 3696 or the reason why a letter was not sent.

To maintain registration, a business must comply with specific terms and conditions. For businesses with approved registrations, the IRS sets an indicator on their tax account. This results in the business being included in the IRS's weekly monitoring to ensure that the business is in compliance with the specific requirements. For businesses identified as not being compliant with one or more of the conditions, a Notice Computer Paragraph 241, *Notice – 637 Registrant*, is generated and forwarded to the Excise Registration Group's manager for evaluation and follow-up actions. These actions may include contacting the business to discuss the problem, conducting further research to determine the extent of the problem, or sending Letter 3696.

Letter 3696 is required to be sent when noncompliance on the part of the business involves an assessment of a Federal tax deposit penalty; failure to file a return of any type; a Form 720, *Quarterly Federal Excise Tax Returns*, was filed owing tax but no excise tax payments or deposits have been made; Form 720 was filed with full payment of tax owed, but deposits were required; the business is in collection status and a third delinquency notice was issued; or deposits were not timely received or the Form 720 was not timely filed after the registration was approved. Figure 2 provides a description of the 11 conditions the IRS uses to identify businesses that may not be in compliance with registration requirements.

⁶ When projecting the results of our statistical sample, we are 95 percent confident that the actual total amount is between 62 and 222 (where the 62 and 222 represent the lower and upper range, respectively).

⁷ The 6,637 includes some businesses that have registered for more than one excise tax activity.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

**Figure 2: Conditions Monitored by the IRS to Identify Businesses
That Are Potentially Not Compliant With Registration Requirements**

Compliance Condition	Description
1. Federal Tax Deposit Penalty Assessed	The deposit penalty can be for any type of tax, including income tax, excise tax, or employment tax.
2. Return Not Filed	Failure to file a return of any type.
3. Form 720 Filed – Tax Owing	Form 720 is filed reflecting a tax liability, but no excise tax payments or deposits have been made.
4. Form 720 No Deposits	Form 720 was filed with full payment of the tax liability with the return, but the applicant/business was required to make deposits.
5. Final Return	Form 720 was filed noting “final return.”
6. Delinquency – Third Notice	The business is in collection status, and a third notice for payment has been issued. The delinquent taxes can be for any type of return.
7. Duplicate Registration	The business has either attempted to obtain, or has obtained, a second registration using the same Employer Identification Number.
8. Deposits Not Received	Two months after the date the Form 637 indicator was input to the Business Master File, the business did not make an excise tax deposit.
9. Form 720 Not Filed	Eight months after the date the Form 637 was input to the Business Master File, a Form 720 was not filed by the business.
10. Bankruptcy	The business filed for bankruptcy.
11. Criminal Investigation Division Freeze	A Criminal Investigation freeze code has posted to the taxpayer account.

Source: IRS's internal guidelines.

As we were unable to ascertain whether the required letter was sent, we provided IRS management with the 2,395 businesses we identified for their review. The IRS reviewed a judgmental sample⁸ of 212 cases. For six of the cases, management noted that a Letter 3696 was not issued when in fact one should have been. For another six cases, for which a letter was not sent, IRS management noted that the excise tax noncompliance issue was being addressed by a tax examiner or a revenue agent as part of contact with the business on a different matter. For the remaining 200 cases, management provided sufficient documentation or explanation to support actions taken to address the noncompliance.

⁸ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Recommendations

The Commissioner, Small Business/Self-Employed Division, should:

Recommendation 1: Develop processes and procedures to ensure that compliance reviews are conducted within the required 60 days and Letter 3681 is mailed within the five days of case assignment.

Management's Response: The IRS agreed with this recommendation and plans to update its processes and procedures with time frames that balance IRS resources and taxpayer needs. IRS management also plans to issue guidance to reflect the changes made.

Recommendation 2: Develop processes and procedures to ensure that tax accounts of currently approved businesses and newly approved businesses include the required Form 637 indicator.

Management's Response: The IRS agreed with this recommendation and plans to issue guidance to include a periodic sample review of approved registrations to ensure that the presence of a 637 indicator is appropriate.

Recommendation 3: Develop processes and procedures to ensure that Letter 3696 is sent when required or case files are notated as to the reason why a letter is not being sent.

Management's Response: The IRS agreed with this recommendation and plans to develop processes and issue guidance to clarify the actions and documentation required when addressing a registrant's compliance condition.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the IRS's excise tax registration program. To accomplish our objective, we:

- I. Selected a statistically valid sample of 69 from a population of 971 approved and 64 from a population of 380 denied applications for excise tax registration during Fiscal Year¹ 2018 (October 1, 2017 – September 30, 2018) and determined if excise tax employees timely and accurately processed these applications. Our sample was selected using a 95 percent confidence level, 5 percent error rate, and ± 5 percent precision factor. Our contracted statistician assisted with developing sampling plans and projections. We reviewed the applications to evaluate if employees:
 - A. Mailed Letter 3681, *637 Notification Letter*, to businesses applying for registration within five days of receiving the Form 637, *Application for Registration (For Certain Excise Tax Activities)*.
 - B. Validated entity information and checked the application for completeness and accuracy against IRS records.
 - C. Accurately performed tax compliance checks against IRS and Accurint records to determine filing, deposit, and payment compliance by the business applying for registration and its shareholders and members.
 - D. Performed the initial compliance review within the allowed 60 days from receipt of the application.
 - E. Took the appropriate action when the application indicated that a crime had been committed or there was a discrepancy between the information provided and the Accurint research results.
 - F. Placed the Form 637 indicator on the Business Master File entity module after the application for registration was approved.
 - G. Timely removed the Form 637 indicator when a business registration was suspended or revoked.
 - H. Sent Letter 3689, *Approval of Excise Tax Registration*, to the business once an approval determination was made on the application.

¹ A fiscal year is any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

- I. Sent Letter 3685, *Denial of Excise Tax Registration*, to the business once a denial determination was made on the application.
- II. Evaluated the effectiveness of the procedures used to monitor continued tax compliance for approved businesses.
 - A. Interviewed IRS management to determine if the indicator is effectively being used to monitor compliance requirements for approved businesses.
 - B. Obtained the programming requirements used by the IRS to identify businesses that are not complying with the 11 conditions of participation in the excise tax program, analyzed the Business Master File to identify businesses meeting any of the 11 conditions of noncompliance, and determined if the programming identified these businesses and whether a notice was issued.
 - C. Obtained an extract of the Form 637 indicator from the Strategic Data Services Division and compared it to the IRS's Issue Based Management Information System² report for the same period. We determined if the Form 637 indicator was accurately placed on the entity module for all businesses with approved excise tax registrations.
 - D. Evaluated the effectiveness of the IRS's process for addressing taxpayers meeting any of the 11 conditions of noncompliance and properly revoking or suspending approved registrations for businesses meeting the criteria.

Data validation methodology

During this review, we relied on the IRS's Business Master File data for Processing Year 2018 stored on the Treasury Inspector General for Tax Administration's Data Center Warehouse and an analysis of data extracted from the Treasury Inspector General for Tax Administration's Strategic Data Services of taxpayer Business Master File entity accounts with a Form 637 indicator for Processing Year 2018. We also relied on reports generated from the IRS's Issue Based Management Information System and Issue Management System. To assess the reliability of computer-processed data, programmers within the Treasury Inspector General for Tax Administration's Data Center Warehouse validated the data files we extracted while we ensured that each data extract contained the specific data elements we requested and that the data elements were accurate. In addition, we performed extensive validation by reviewing random samples of each file and verified that the data in the files were the same as the data captured in the IRS's Integrated Data Retrieval System, the Issue Based Management Information System, and the Issue Management System. As a result of our testing, we determined that the data were sufficiently reliable for purposes of this report.

² The IRS's Issue Based Management Information System is a software program used to prepare reports from a variety of IRS databases.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the processes for reviewing and approving excise tax registration applications and ensuring that businesses with approved excise tax registrations continue to comply with requirements. We evaluated these controls by reviewing policies and procedures, interviewing IRS employees and management, manually reviewing samples of approved and denied Form 637 applications, and performing data analyses to identify and evaluate taxpayers who are potentially noncompliant with excise tax requirements.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Appendix II

Major Contributors to This Report

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)

Diana M. Tengesdal, Director

Nikole L. Smith, Audit Manager

Tanya L. Boone, Lead Auditor

Quinn A. Major, Auditor



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Commissioner, Small Business/Self-Employed Division
Deputy Commissioner, Small Business/Self-Employed Division
Director, Examination Quality and Technical Support, Small Business/Self-Employed Division
Director, Headquarters Examination, Small Business/Self-Employed Division
Director, Specialty Examination Policy and Quality, Small Business/Self-Employed Division
Director, Enterprise Audit Management



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 424 Forms 637, *Application for Registration (For Certain Excise Tax Activities)*, were not timely processed, resulting in delays in taxpayers being able to participate in excise tax activities, including conducting certain transactions tax free or at a reduced tax rate or filing a claim for refund of excise taxes (activities they cannot complete until their application is approved) (see page 4).

Methodology Used to Measure the Reported Benefit:

We reviewed a statistically valid sample of 133 Form 637 applications¹ (69 from a population of 971 approved and 64 from a population of 380 denied) received during October 1, 2017, through September 30, 2018. We found that, for 44 (33 percent) applications, the IRS did not process the application timely. Based on the results of our statistically valid sample, we estimate that 424 Form 637 applications² were not timely processed.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; six noncompliant businesses did not receive Letter 3696, *Results of 637 Compliance Review*, as required to resolve the compliance issue (see page 4).

Methodology Used to Measure the Reported Benefit:

Our review of the tax accounts associated with 6,637 approved Fiscal Year³ 2018 excise tax registrants identified 2,395 unique businesses that were not compliant with one or more of the conditions requiring the mailing of a Letter 3696. The IRS reviewed a judgmental sample of

¹ Our sample was selected using a 95 percent confidence interval, 5 percent error rate, and ± 5 percent precision factor.

² When projecting the results of our statistical sample, we are 95 percent confident that the actual total amount is between 315 and 533 (where the 315 and 533 represent the lower and upper range, respectively).

³ A fiscal year is any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

212 cases. For six of the cases, management noted that a Letter 3696 was not issued when in fact one should have been. For another six cases, for which a letter was not sent, IRS management noted that the excise tax noncompliance issue was being addressed by a tax examiner or a revenue agent as part of contact with the business on a different matter. For the remaining 200 cases, management provided sufficient documentation or explanation to support actions taken to address the noncompliance.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Appendix V

*Form 637, Application for Registration
(For Certain Excise Tax Activities),
Activity Letters and Descriptions*

Activity Letter	Description	Required to Register Yes/No
A	Manufacturer of gas-guzzler automobiles, sport fishing equipment (including fishing rods and fishing poles), fishing tackle boxes, bows, quivers, broadheads, points, arrow shafts, taxable tires, taxable medical devices, or vaccines.	No
B	Buyer of sport fishing equipment (including fishing rods and fishing poles), fishing tackle boxes, gas-guzzler automobiles, bows, quivers, broadheads, points, taxable medical devices, or vaccines for further manufacture or for resale to a buyer for further manufacture.	No
C	Buyer of taxable tires for use on or in connection with the sale of another article the buyer manufactures and sells (1) for export, (2) to State and local governments, (3) to nonprofit educational organizations, or (4) as supplies for vessels or aircraft.	No
D	Buyer with a place of business in the United States purchasing taxable medical devices, vaccines, gas-guzzler automobiles, taxable tires, sport fishing equipment (including fishing rods and fishing poles), fishing tackle boxes, bows, quivers, broadheads, points, or arrow shafts for export or for resale to a second purchaser for export.	No
E	Buyer (other than State or local government) of gas-guzzler automobiles for ambulance, law enforcement, or firefighting.	No
F	Nonprofit educational organization, other than a public school, buying taxable tires, certain heavy vehicles, sport fishing equipment (including fishing rods and fishing poles), fishing tackle boxes, bows, quivers, broadheads, points, or arrow shafts for its exclusive use.	No
I	Buyer (other than nonprofit educational organization or State or local government) of taxable tires for use on certain intercity, local, or school buses.	No
K	Buyer of kerosene for a feedstock purpose.	No



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Activity Letter	Description	Required to Register Yes/No
M	Blender of gasoline, diesel fuel (including a diesel-water fuel emulsion), or kerosene, producing a taxable fuel outside the bulk transfer/terminal system, including blenders of alcohol fuel mixtures, alternative fuel mixtures, biodiesel mixtures, and renewable diesel mixtures.	Yes
Q	First retail seller of certain heavy vehicles.	No
S	Enterer, position holder, refiner, terminal operator, or throughputter of gasoline, diesel fuel (including a diesel-water fuel emulsion), or kerosene or industrial user of gasoline.	Yes
V	Manufacturer, importer, or buyer of ozone-depleting chemicals for export.	No
X	Pipeline operator or vessel operator (including certain deep-draft vessels) within the bulk transfer/terminal system.	Yes
Y	Buyer of kerosene for its use in commercial aviation (other than foreign trade).	No
AB	Producers and importers of agri-biodiesel.	Yes
AF	Producers and importers of alcohol.	Yes
AL	Alternative fueler that sells for use or uses alternative fuel as a fuel in a motor vehicle or motorboat.	Yes
AM	Alternative fueler that produces an alternative fuel mixture that is sold for use or used in the alternative fueler's trade or business.	Yes
BC	Qualified blood collector organization buying taxable fuel, taxable tires, and certain heavy vehicles; claiming exemption from the communications tax and heavy highway vehicle use tax; or to claim a credit or payment of certain excise taxes, for its exclusive use in the collection, storage, or transportation of blood.	No
CC	Credit card issuer that issues credit cards for sales of taxable fuel to a state or local government for its exclusive use or for sales of gasoline to a nonprofit educational organization for its exclusive use.	Yes
NB	Producers and importers of biodiesel (other than agri-biodiesel) and renewable diesel.	Yes
QR	Qualified retailer of diesel fuel or kerosene sold in Alaska for nontaxable uses.	No
SB	Producers of second generation biofuel.	Yes
UA	Ultimate vendor that sells kerosene for use in aviation.	No
UB	Ultimate vendor that sells undyed diesel fuel or undyed kerosene for use in certain intercity and local buses.	No
UP	Ultimate vendor that sells kerosene from a blocked pump.	No



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Activity Letter	Description	Required to Register Yes/No
UV	Ultimate vendor that sells (a) undyed diesel fuel or undyed kerosene to a State or local government for its exclusive use, or (b) gasoline (including aviation gasoline) to a State or local government for its exclusive use or to a nonprofit educational organization for its exclusive use.	No

Source: IRS Form 637.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Appendix VI

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

August 21, 2019

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mary Beth Murphy *Mary Beth Murphy*
Commissioner, Small Business/Self-Employed Division

SUBJECT: Excise Tax Registrations Are Not Always Timely or Accurately
Processed (Audit # 201840011)

Thank you for the opportunity to review and comment on the above subject draft audit report. Under the Internal Revenue Code and regulations, each person who engages in certain activities subject to federal excise tax or seeks an excise tax benefit must register with the IRS to engage in these activities. Benefits of registration include the right to sell or buy an article tax-free, at a reduced tax rate, or to file a claim.

Timely processing of excise tax registration applications is an important part of ensuring taxpayers are afforded the benefits that come with an excise tax registration number. As detailed in this report, the Form 637, *Application for Registration (For Certain Excise Tax Activities)*, application procedures are still primarily a manual process. Applications are submitted by mail or fax, then scanned and reviewed by tax examiners and revenue agents to make an approval or denial determination. We continue to face challenges with declining resources leading to increased employee workload and resulting in delays.

We have completed enhancements to the program including an extensive Form 637 Registration Program web page (<https://www.irs.gov/businesses/small-businesses-self-employed/637-registration-program>) and an online Form 637 Registration Status Check (<https://apps.irs.gov/app/exciseTax/>) for taxpayers to confirm if another business has a valid excise tax registration. We are dedicated to ensuring compliance within the excise tax registration program and will update our policies and procedures as needed to achieve this goal.

Attached is our detailed response to your recommendations. If you have any questions, please contact me or Brenda Dial, Director, Examination Operations, Small Business/Self-Employed Division.

Attachment



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

Attachment

RECOMMENDATION 1:

The Commissioner, Small Business/Self-Employed Division, should develop processes and procedures to ensure compliance reviews are conducted within the required 60 days and that Letter 3681, *637 Notification Letter*, is mailed within the five days of case assignment.

CORRECTIVE ACTION:

While we agree with the recommendation, we can implement it only to the extent we have sufficient resources. We will update our processes and procedures with time frames that balance IRS resources and taxpayer needs and will issue guidance to reflect changes made.

IMPLEMENTATION DATE:

October 15, 2020

RESPONSIBLE OFFICIAL:

Director, Headquarters Exam, Specialty Exam Policy, Small Business/Self-Employed Division (SB/SE)

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:

The Commissioner, Small Business/Self-Employed Division, should develop processes and procedures to ensure tax accounts of currently approved businesses and newly approved businesses include the required Form 637 indicator.

CORRECTIVE ACTION:

We agree with the recommendation. We will issue guidance to include a periodic sample review of approved registrations to ensure the presence of a 637 indicator is appropriate.

IMPLEMENTATION DATE:

June 15, 2020

RESPONSIBLE OFFICIAL:

Director, Headquarters Exam, Specialty Exam Policy, Small Business/Self-Employed Division (SB/SE)

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.



*Excise Tax Registrations Are Not
Always Timely or Accurately Processed*

2

RECOMMENDATION 3:

The Commissioner, Small Business/Self-Employed Division, should develop processes and procedures to ensure Letter 3696, *Results of 637 Compliance Review*, is sent when required or case files are notated as to the reason why a letter is not being sent.

CORRECTIVE ACTION:

We agree with the recommendation. We will develop guidelines and issue guidance to clarify the actions and documentation required when addressing a registrant's compliance condition.

IMPLEMENTATION DATE:

June 15, 2020

RESPONSIBLE OFFICIAL:

Director, Headquarters Exam, Specialty Exam Policy, Small Business/Self-Employed Division (SB/SE)

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.