

COLLECT THE REVENUE

Through this strategic goal, ATF plays a key role in the Federal Government's tax collection process. In FY 2002, the Bureau collected \$15.1 billion in taxes and fees levied on alcohol and tobacco products, firearms, and ammunition. ATF spent approximately \$46.5 million of its appropriated funds in FY 2002 to collect this revenue. (See Financial Statements – Statement of Net Cost.)

Strategic Goal Overview

Maintain a sound revenue management and regulatory system that continues reducing taxpayer burden, improves service, collects the revenue due, and prevents tax evasion and other criminal conduct.

This strategic goal is accomplished through three programs:

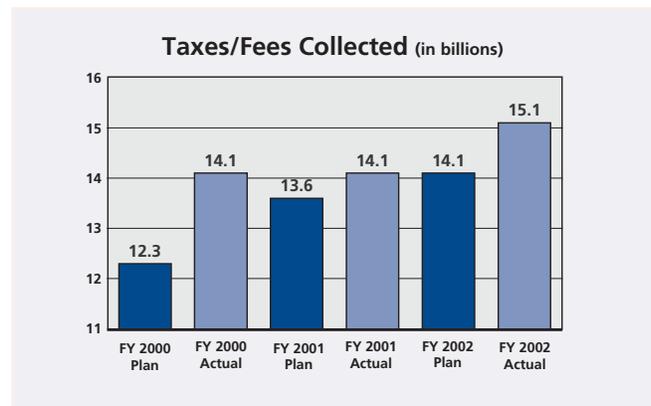
- *Reduce Taxpayer Burden and Improve Service*
- *Collect All the Revenue that is Rightfully Due*
- *Prevent Tax Evasion and Other Criminal Conduct in the Regulated Industries*

Strategies/Key Measures

ATF's effectiveness in these three programs is demonstrated through the following Performance Measures:

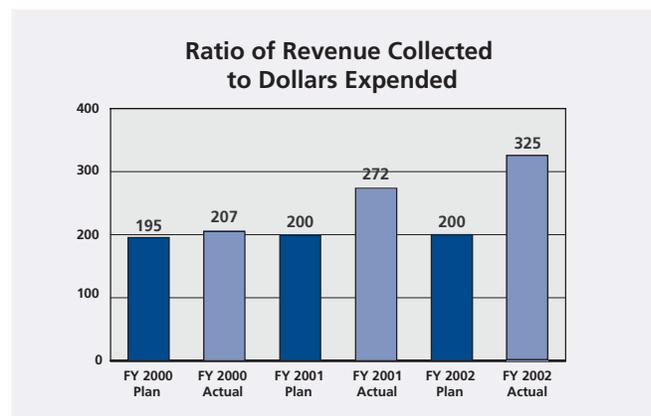
Performance Measure: Taxes/fees collected from alcohol, tobacco, firearms and explosives industries.

This measure includes revenue collected through alcohol, tobacco, firearms, and ammunition excise taxes, firearms and explosives license/permit fees, and special occupational taxes. On January 1, 2000, and January 1, 2001, there were increases in the tax rate levied on tobacco. These increases in the tax rate have contributed to an increase in the revenue collected.



Performance Measure: Ratio of taxes and fees collected vs. resources expended.

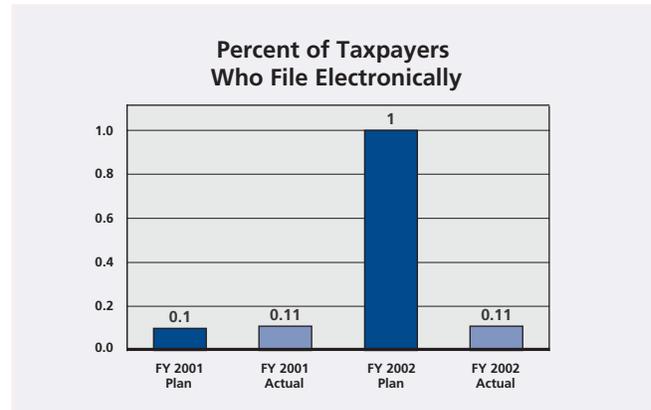
This measure represents the amount of taxes and fees collected for every dollar spent on collections. Tax returns are processed at ATF's National Revenue Center, and the cost of collecting the revenue is reflected in the statement of net cost, which is reviewed/audited on an annual basis by an external auditor. (See Statement of Net Cost).



Performance Measure: Percent of taxpayers who file excise tax returns and required monthly operation reports electronically.

This measure represents the percent of alcohol, tobacco, and firearms taxpayers that use electronic filing instead of paper filing. The number of taxpayers for FY 2002 was 5,660, of which six participated in the Pay.gov program and filed electronically, for a figure of 0.11 percent.

Although the percentage of taxpayers in the pilot only represents .11% of total taxpayers, the dollars processed through Pay.gov represent approximately 27% of revenues collected. Expansion of the pilot is delayed until a phase of the ongoing systems integration project is completed.



Program: Reduce Taxpayer Burden and Improve Service

During FY 2002, ATF's service strategy included efforts to further electronic government, the automation of business applications at the National Revenue Center (NRC).

During FY 2002, ATF continued its partnership with the Financial Management Service (FMS) in piloting Pay.gov, a government-wide electronic filing system being developed by FMS. Six tobacco manufacturers continued to file and pay their excise taxes via Pay.gov. For the fiscal year, there were approximately 150 transactions totaling \$3.75 billion filed through Pay.gov. ATF also expanded the excise tax pilot to include six large alcohol producers (2 each – breweries, wineries and

distilleries) in September. In FY 2002, ATF developed and implemented another pilot for the submission of the tobacco manufacturer's monthly report. This pilot includes two additional tobacco manufacturers. These companies initiated the electronic filing of their monthly reports in September. Additional work during FY 2002 included electronic forms development of two brewer's monthly reports and four distilled spirits monthly reports. The ultimate goal is to allow industry members to file all payments, returns, reports, and applications on-line.

ATF will continue to rely on industry support as it moves toward full system integration.

Program: Collect All the Revenue that is Rightfully Due

ATF collected \$15.1 billion, before refunds, in Federal excise taxes, interest, penalties, and fees in FY 2002. Ninety-eight percent of this revenue was derived from payments of alcohol and tobacco excise taxes. ATF's revenue management program includes a variety of processes and functions based on reviewing, auditing and recording of tax returns, deposits, and operation reports. The program includes the accounting for all deposits and payments for taxes and fees from the alcohol, tobacco, firearms, ammunition, and explosives industries.

During FY 2002, ATF conducted 1,331 inspections at revenue producing plants resulting in the detection of 731 violations, 2,016 tax adjustments, and over \$6 million in additional tax revenue. ATF focuses its on-site inspections of alcohol, tobacco, firearms, and ammunition taxpayers on facilities that pose the greatest risk to revenue. The factors considered include volume of operations, compliance history, internal controls, and financial condition. (See Financial Statements, Note 17, Non-exchange Revenue, for a more detailed description of the various types and sources of revenues.)

The National Revenue Center monitored tax collections by auditing tax returns, levying assessments, initiating enforced collection action, analyzing required reports, requesting field verifications, and accounting for tax payments and related refunds. ATF processed 13 offers-in-compromise resulting from violations of the Internal Revenue Code, which resulted in an additional \$683,790 being paid to the Federal government during FY 2002. A total of 1,572 new assessments was generated by issuance of Notice and Demand Letters in FY 2002. Of these, 528 were generated due to bad checks, while others were due to tax returns filed late or without payment, or failure to properly document exported alcohol products. There were 1,584 assessments closed during the year.

Flavored Malt Beverages

In FY 2002, ATF conducted a comprehensive study of the classification and labeling for “flavored malt beverages.” Many of the products currently marketed as malt beverage products have varied and diverse characteristics that distinguish them from traditional malt beverages. The characteristics are so diverse that the differences between flavored malt beverages and distilled spirits or wine products are becoming increasingly blurred and undefined. Beverages containing alcohol that do not meet the definition of wine or beer under the Internal Revenue Code (IRC) are classified as distilled spirits, which have a tax rate 50% to 100% higher than the malt beverage tax rate, depending on the formulation. Because this poses a revenue issue, ATF is taking steps to clarify the definitions for beer and flavored malt beverages in the regulations.



ATF employee reviewing documents at ATF's National review Center in Cincinnati

Program: Prevent Tax Evasion and Other Criminal Conduct in the Regulated Industries

ATF is engaged in an ongoing effort to reduce a rising trend in the illegal diversion of cigarettes and distilled spirits products. Diversion activity generally occurs when legally manufactured or produced alcohol and tobacco products are diverted from their normal legal distribution channels and sold in violation of Federal laws and regulations. Diversion activities defraud the United States Federal Government and individual States

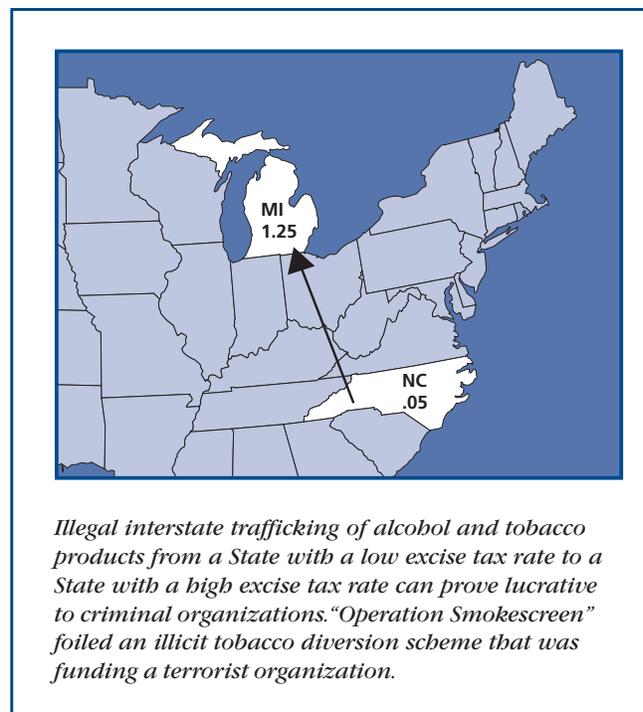
of tax revenue. For example, cigarettes and distilled spirits are often fraudulently identified for export markets (for which there is no tax liability) when, in fact, they are diverted into the United States domestic market for sale (where there is tax liability). ATF's goal to ensure compliance with U.S. laws will greatly reduce the illegal diversion of alcohol and tobacco products.

During FY 2002, ATF noticed a significant growth in the trafficking of counterfeit cigarette and tax stamps. This sharp increase in counterfeit products offered to consumers is due to the steady increase in State and Federal cigarette excise taxes. In efforts to combat the illegal trafficking of counterfeit cigarettes, ATF worked with legitimate tobacco manufacturers and gained vast amounts of knowledge regarding the identification of counterfeit tax stamps, cigarettes, and their packaging. The Alcohol and Tobacco Diversion Branch and ATF laboratory are also playing a vital role in supporting field agents and inspectors with this issue. Knowledge of field-testing methods gained through the coordination with the tax stamp producer, and tobacco manufacturers, has provided agents and inspectors the ability to test suspect cigarettes in the field.

In FY 2002, an ongoing ATF tobacco investigation established that proceeds from cigarette smuggling were being funneled to support a terrorist organization. Immigration and Naturalization Service (INS) and the Iredell County, North Carolina Sheriff's Department participated in this extensive investigation. The case resulted in the arrest of 18 individuals on ATF and INS violations. The seizures included one residence, a business, numerous bank accounts, cash, vehicles, and cigarettes. Ultimately, 25 individuals were charged with contraband cigarette trafficking, money laundering, Racketeer Influenced and Corrupt Organizations Act of 1970 (RICO), wire fraud, conspiracy, visa/marriage fraud, and material support to terrorist organization.

On March 11, 2002, guilty pleas to racketeering conspiracy and conspiracy to commit money laundering for funneling profits from a cigarette smuggling operation to a terrorist group were entered. One defendant was charged with planning to provide the terrorist organization with cash and supplies, including stun guns, blasting equipment, night vision goggles, and mine-detection equipment.

In June 2002, two defendants were convicted of RICO, Contraband Cigarette Trafficking Act (CCTA), money laundering, immigration fraud, and bank fraud. One defendant was also the first individual to be convicted of conspiracy and providing material support to a terrorist organization. Outstanding fugitive warrants are still pending against two defendants.



ATF is engaged in an ongoing effort to obtain and update agreements with State revenue agencies to share tax return information. This sharing of tax information provides a means to compare taxpayers, revenue, and other matters related to the sale and distribution of alcohol and tobacco products pursuant to 26 USC 6103(d).

Discussions with the U.S. Federal Trade Commission were held regarding misleading advertising statements of Internet sales of tobacco products. Individuals were offering "tax-free" and "duty-free" cigarettes for sale on the Internet. ATF held that this advertising was not truthful. Not all sales are tax and duty-free. Meetings with the States have also resulted in the possibility of joint investigations to identify potential revenue losses. ATF, in cooperation with the States, would investigate those companies that removed taxable commodities without payment of excise tax.

During 2002, ATF met with Mexican Customs (Aduana Mexico) and other law enforcement officials to discuss tobacco smuggling schemes, hot spots and the methods used to combat this illegal activity. Through the coordination of ATF's Mexico Country Office (MCO), located in Mexico City, ATF met with key Mexican tobacco industry, regulatory and enforcement officials on these issues. ATF

is performing a threat assessment in an effort to better target and understand the problem Mexico is facing in relation to the illegal trafficking of counterfeit and contraband cigarettes.

ATF, the Royal Canadian Mounted Police, and the Canada Customs and Revenue Agency continue to work together to determine the threat to the revenues of the United States and Canada posed by cross-border cigarette smuggling. Recently, ATF placed an Assistant Country Attaché at the U.S. Embassy in Ottawa, Ontario, to strengthen the Canadian partnership as both nations work collaboratively to combat revenue losses from contraband cigarette trafficking. In an effort to devise joint strategies to combat this illicit activity, a joint tobacco diversion workshop is planned for FY 2003.

ATF hosted the International Conference on Illicit Tobacco Trade in July 2002. Law enforcement, customs, and taxation and revenue experts from 142 Member States of the World Health Organization met to identify best practices to combat illicit tobacco trade and to establish or enhance partnerships and coalitions, exchange information, and provide the impetus for

further informal conferences. Delegates focused on licensing, record keeping, labeling and packaging, product tracking and tracing, border controls, and mutual cooperation and information-sharing approaches.

The reports resulting from this meeting will serve as a reference for governments at the national, sub-national, and local levels seeking to enhance their regulatory controls to prevent unlawful distribution of tobacco products. The test practices documented in the reports serve to create or strengthen sound and lawful distribution systems of tobacco products, thereby ensuring that governments collect tobacco revenues rightfully due.

In FY 2002, the value of cash, vehicles, beverage alcohol, and tobacco products seized during diversion investigations by ATF agents, inspectors, and auditors totaled over \$1.6 million being credited to the Treasury Asset Forfeiture Fund. In FY 2002, 160 diversion cases resulted in 79 defendants recommended for prosecution.

Also during FY 2002, ATF conducted 25 seminars with foreign governments and other U.S. Federal and State agencies on diversion of alcohol and tobacco products.



Delegates from three-quarters of the world shared best practices at the International Conference on Illicit Tobacco, hosted by ATF in July 2002

Shown from left to right: Director Buckles, Deputy Director Benton