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DEPARTMENT OF THE TREASURY

Bureau of Alcohol, Tobacco and Firearms

27 CFR Part 53

[T.D. ATF-404; Ref: Notice No. 836]

RIN 1512-AB49

Firearms and Ammunition Excise Taxes, Parts and Accessories (97R-
1457P)

AGENCY: Bureau of Alcohol, Tobacco and Firearms (ATF), Department of
the Treasury.

ACTION: Final rule, Treasury decision.

SUMMARY: This final rule amends regulations relating to the manufacturers excise tax on firearms and ammunition. Under 26 U.S.C. 4181, a tax is imposed on the sale by the manufacturer, importer or producer of firearms, shells, and cartridges. The tax is 10 percent of the sale price for pistols and revolvers, 11 percent for firearms (other than pistols and revolvers), and 11 percent for shells and cartridges. Current regulations provide that no tax is imposed by section 4181 on the sale of parts or accessories of firearms, pistols, revolvers, shells, and cartridges when sold separately or when sold with a complete firearm. This final rule amends the regulations to clarify which parts and accessories must be included in the sale price when calculating the tax on firearms.

DATES: Effective November 30, 1998.

FOR FURTHER INFORMATION CONTACT: Marsha D. Baker, Regulations Division,

Bureau of Alcohol, Tobacco and Firearms, 650 Massachusetts Avenue,

N.W., Washington, D.C. 20226 (202-927-8476). **CORRECTION: phone number should be 202-927-8177.**

SUPPLEMENTARY INFORMATION:

Background

The Bureau of Alcohol, Tobacco and Firearms (ATF) is responsible for collecting the firearms and ammunition excise tax imposed by section 4181. The Pittman-Robertson Wildlife Restoration Act, 16 U.S.C. 669 et seq., requires that an amount equal to all of the revenue collected under section 4181 be deposited into the Federal Aid to

Wildlife Restoration Fund. This Fund is apportioned to the States for hunter safety programs, maintenance of public target ranges, and wildlife and wetlands conservation.

The current regulation provides that no tax is imposed by section on the sale of parts or accessories of firearms, pistols, revolvers, shells, and cartridges when sold separately or when sold with a complete firearm. This regulation was at issue in *Auto-Ordnance Corp. v. United States*, 822 F.2d 1566 (Fed. Cir. 1987). In this case a manufacturer of firearms sued to recover excise taxes paid on sights and compensator units sold with rifles it manufactured. The manufacturer claimed that these parts were nontaxable accessories that should not be included in the taxable sale price of the rifles. The Internal Revenue Service (IRS), the agency responsible for administering the tax on firearms at that time, contended that the

sights and compensator units were component parts of the rifles that must be included in the taxable sale price.

The court noted that the position of the IRS that all component parts of a ``commercially complete" firearm must be included in the sale price was a concept that was not found in the regulations. Since the regulations did not specify which parts are component parts of a firearm nor define the term ``accessories," the court found that it was appropriate to look beyond the language of the regulation. The court discussed several dictionary definitions of the term ``accessories" as well as tariff and customs classification cases. The court held that the sights and compensator units were nontaxable accessories since they were readily removable and of secondary or subordinate importance to the function of the firearm.

Since taking over the administration of the firearms and ammunition

excise tax from the IRS in 1991, ATF has issued numerous rulings on parts and accessories. ATF has found it increasingly difficult to apply the regulation on parts and accessories as interpreted by the court in *Auto-Ordnance*. For example, the "secondary or subordinate importance" test is difficult to apply to parts that are essential for the safe operation of the firearm. Arguably, such parts are essential to the function of the firearm and should be included in the taxable sale price. However, if such parts are not needed to fire the firearm, it is possible that a Federal court, applying the rationale of *Auto-Ordnance*, would hold that such parts are nontaxable accessories.

Notice of Proposed Rulemaking

On August 29, 1996, ATF published in the Federal Register a notice

of proposed rulemaking (Notice No. 836, 61 FR 45377) proposing to provide definitions for "component parts" that must be included in the taxable sale price and "nontaxable parts" and "nontaxable accessories" that are excluded from the taxable sale price. The notice stated that the purpose of the proposed definitions is to reinstate the longstanding "commercial completeness" test of the IRS in a manner that will withstand judicial scrutiny. The notice stated that the effect of the definitions would be to replace the readily removable/essential to the function test of the Auto-Ordnance case with a more objective, predictable standard to use in determining whether items sold with a firearm are includible in the tax basis.

Analysis of Comments

ATF received nine (9) written comments during the comment period in response to Notice No. 836. These comments were submitted by three (3) members of the public, four (4) Federal firearm licensees, and two (2) firearms industry organizations. All nine respondents opposed the proposed regulations.

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One commenter felt that ATF lacks the authority to impose a tax and should restrict itself to enforcement matters. The authority to administer the excise tax provisions of 26 U.S.C. 4181 was transferred from the IRS to ATF on January 1, 1991, by Treasury Order No. 120-03 (55 FR 47422, November 13, 1990). The order gave ATF the authority to issue regulations with respect to the administration, collection and

enforcement of firearms and ammunition excise taxes.

One commenter requested that ATF modify the payment schedule for excise taxpayers to a quarterly basis. Current regulations require bimonthly deposits for most taxpayers. The commenter stated that some manufacturers provide economic incentives to dealers by providing an extended payment schedule of three, six, or nine months for those accepting products early in the year. This process may cause some manufacturers to borrow money with which to pay excise tax. The commenter suggested that quarterly payments reflecting seasonal fluctuations in consumer demands would assist in alleviating this problem.

The deposit system for payment of the taxes imposed by section 4181 was not one of the issues raised for public comment by Notice No. 836.

Moreover, a change in the current system would require a statutory

amendment. Accordingly, ATF is not adopting this comment.

Five (5) commenters opposed the proposed regulations on the basis that they would overturn the Auto-Ordnance decision and result in more tax being paid by taxpayers and consumers. The commenters believe that by reinstating the commercial completeness test of the IRS, ATF is trying to circumvent the court's finding in Auto-Ordnance. The commenters are opposed to replacing the readily removable/essential to the function test with the commercial completeness test, because they consider the court to have already repudiated the application of a commercial completeness test.

The Auto-Ordnance case makes it clear that the Federal Circuit rejected the IRS "commercial completeness" test only because that test was not clear in the regulations. The court did not hold that the IRS position was an impermissible interpretation of the statute.

Accordingly, ATF does not believe the Auto-Ordnance case precludes ATF from establishing a for parts and accessories different from that used by the court.

Four (4) commenters expressed opposition to proposed section 53.61(b)(5), which provides that when taxable firearms are sold by a manufacturer or importer without component parts, the separate sale of the component parts to the same vendee will be considered, in the absence of evidence to the contrary, to have been made in connection with the sale of the basic article even though the component parts are shipped separately.

These four respondents stated that the implementation of this provision will result in confusing and complex recordkeeping requirements. They stated that recordkeeping requirements would become more difficult and complex for the manufacturers since customer

requests for mounts and other accessories on a separate invoice to the dealer would become taxable. The commenters noted that a manufacturer who ships a firearm without sights but provides the retailer with the opportunity to add them at a later date does so for market-driven reasons rather than for evading the small amount of tax on the sights.

ATF's intent in proposing the separate sales provision of "53.61(b)(5) was to include in the regulations the longstanding position that tax cannot be evaded through separate shipment and sale of component parts. However, ATF did not intend to impose a continuing obligation on firearms importers and manufacturers to keep records of their sales of parts to vendors and attempt to match them up with previous sales of firearms. Accordingly, ATF is adopting this comment and deleting proposed "53.61(b)(5) from the final regulations.

In addition, ATF is amending wording in proposed "53.61(b)(6)(ii)

to remove the term ``parts in a partially completed state." ATF believes this language is unnecessary.

Eight (8) commenters expressed opposition to the proposed regulation because they believed it may be more costly for the manufacturers by increasing their taxes and driving up retail prices.

There was also concern that this would force taxpayers to borrow money to meet tax payments in advance of receipt of trade receivables. The commenters stated that this would lead to a negative impact on sales, reduction of the market, and reduction of revenues. They stated that such a change in the regulations would increase costs incurred by the regulated industry.

ATF does not believe that the implementation of this regulation will place an undue financial burden on excise taxpayers or have a significant impact on sales, the market, or revenues. This regulation

will, however, make it easier for the taxpayer to understand the excise taxes for parts and accessories. A better understanding of the distinction between taxable and nontaxable items will lead to fewer mistakes in computing tax. In addition, the clarified definitions of parts and accessories will make it easier for the government to administer the regulation.

Two (2) commenters stated that the burden of supporting the Aid to Wildlife Restoration Fund should be placed upon those who benefit from the Fund, such as hunters, campers, and hikers as well as businesses whose activities (i.e., pollution, timber cutting, etc.) are detrimental to wildlife. Since the taxes paid into the Fund are imposed by statute on manufacturers and importers of firearms and ammunition, legislation would be necessary to require contribution to the Fund by other persons. This final rule also adds a definition of the term

``knockdown condition" to the regulations in Sec. 53.11. Since the new definition of ``parts and accessories" uses this term, the definition of ``knockdown condition" is added for clarity.

Regulatory Flexibility Act

It is hereby certified under the provisions of the Regulatory Flexibility Act, 5 U.S.C. 605(b), that this final rule will not have a significant economic impact on a substantial number of small entities.

This rule merely clarifies existing regulations. A copy of the proposed rule was submitted to the Chief Counsel for Advocacy of the Small Business Administration in accordance with 26 U.S.C. 7805(f). No comments were received.

Executive Order 12866

It has been determined that this regulation is not a significant regulatory action as defined by Executive Order 12866. Accordingly, the final rule is not subject to the analysis required by this Executive Order.

Paperwork Reduction Act

The provisions of the Paperwork Reduction Act of 1995, Public Law 104-13, 44 U.S.C. chapter 35, and its implementing regulations, 5 CFR part 1320, do not apply to this final rule because there are no new reporting or recordkeeping requirements.

Disclosure

Copies of the notice of proposed rulemaking, the written comments, and this final rule will be available for public inspection during normal business hours at: ATF Public Reading Room, Room 6480, 650 Massachusetts Avenue, NW, Washington, D.C. 20226.

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Drafting Information

The author of this document is Marsha D. Baker, Regulations Division, Bureau of Alcohol, Tobacco and Firearms.

List of Subjects in 27 CFR Part 53

Administrative practice and procedure, Arms and munitions,
Authority delegations, Export, Imports, Penalties, Reporting and
recordkeeping requirements.

Authority and Issuance

Accordingly, 27 CFR Part 53, Manufacturers Excise Taxes--Firearms
and Ammunition, is amended as follows:

PART 53--MANUFACTURERS EXCISE TAXES--FIREARMS AND AMMUNITION

Paragraph 1. The authority citation for 27 CFR part 53 continues to

read as follows:

Authority: 26 U.S.C. 4181, 4182, 4216-4219, 4221-4223, 4225,
6001, 6011, 6020, 6021, 6061, 6071, 6081, 6091, 6101-6104, 6109,
6151, 6155, 6161, 6301-6303, 6311, 6402, 6404, 6416, and 7502.

Par. 2. Section 53.11 is amended by adding a new definition for the
term ``knockdown condition" to read as follows:

Sec. 53.11 Meaning of terms

* * * * *

Knockdown condition. A taxable article that is unassembled but

complete as to all component parts.

* * * * *

Par. 3. Section 53.61(b) is revised to read as follows:

Sec. 53.61 Imposition and rates of tax.

* * * * *

(b) Parts or accessories. (1) In general. No tax is imposed by section 4181 of the Code on the sale of parts or accessories of firearms, pistols, revolvers, shells, and cartridges when sold separately or when sold with a complete firearm for use as spare parts or accessories. The tax does attach, however, to sales of completed firearms, pistols, revolvers, shells, and cartridges, and to sale of

such articles that, although in knockdown condition, are complete as to all component parts.

(2) Component parts. Component parts are items that would ordinarily be attached to a firearm during use and, in the ordinary course of trade, are packaged with the firearm at the time of sale by the manufacturer or importer. All component parts for firearms are includible in the price for which the article is sold.

(3) Nontaxable parts. Parts sold with firearms that duplicate component parts that are not includible in the price for which the article is sold.

(4) Nontaxable accessories. Items that are not designed to be attached to a firearm during use or that are not, in the ordinary course of trade, provided with the firearm at the time of the sale by the manufacturer or importer are not includible in the price for which

the article is sold.

(5) Examples. (i) In general. The following examples are provided

as guidelines and are not meant to be all inclusive.

(ii) Component parts. Component parts include items such as a frame

or receiver, breech mechanism, trigger mechanism, barrel, buttstock,

forestock, handguard, grips, buttplate, fore end cap, trigger guard,

sight or set of sights (iron or optical), sight mount or set of sight

mounts, a choke, a flash hider, a muzzle brake, a magazine, a set of

slings, and/or an attachable ramrod for muzzle loading firearms

when provided by the manufacturer or importer for use with the firearm

in the ordinary course of commercial trade. Component parts also

include any part provided with the firearm that would affect the tax

status of the firearm, such as an attachable shoulder stock.

(iii) Nontaxable parts. Nontaxable parts include items such as

extra barrels, extra sights, optical sights and mounts (in addition to iron sights), spare magazines, spare cylinders, extra choke tubes, and spare pins.

(iv) Nontaxable accessories. Nontaxable accessories include items such as cleaning equipment, slings, slip on recoil pads (in addition to standard buttplate), tools, gun cases for storage or transportation, separate items such as knives, belt buckles, or medallions. Nontaxable accessories also include optional items purchased by the customer at the time of retail sale that do not change the tax classification of the firearm, such as telescopic sights and mounts, recoil pads, slings, sling swivels, chokes, and flash hidere/muzzle brakes of a type not provided by the manufacturer or importer of the firearm in the ordinary course of commercial trade.

* * * * *

Signed: May 28, 1998.

John W. Magaw,

Director.

Approved: August 3, 1998.

Dennis M. O'Connell,

Acting Deputy Assistant Secretary (Regulatory, Tariff and Trade

Enforcement).

[FR Doc. 98-26133 Filed 9-30-98; 8:45 am]

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