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REPORT TO THE CONGRESS



BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

A Case For Providing Pay-As-You-Go Privileges To Military Personnel For State Income Taxes

Multiagency

Providing withholding privileges to military personnel would make it easier for them to meet their State income tax obligations. States would benefit from increased revenues and reduced administrative costs. The pay-as-you-go privilege is already accorded to other Federal employees.

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

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To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the reasons why pay-as-you-go
privileges should be provided to military personnel for
State income taxes.

Withholding taxes from pay makes it easier for individ-
uals to pay their taxes, enhances voluntary compliance with
income tax laws, and greatly simplifies tax administration.
This pay-as-you-go privilege for State income taxes is ac-
corded Federal civilian employees but not members of the
armed services. We wanted to determine if service members
had problems paying these taxes without having this privilege.

We made our review pursuant to the Budget and Accounting
Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act
of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Secretary
of Defense and the Director, Office of Management and Budget.

Comptroller General
of the United States

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ABBREVIATIONS

DOD Department of Defense

GAO General Accounting Office

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

A CASE FOR PROVIDING
PAY-AS-YOU-GO PRIVILEGES
TO MILITARY PERSONNEL FOR
STATE INCOME TAXES
Multiagency

D I G E S T

The Congress should enact legislation to provide military personnel with pay-as-you-go privileges for State income taxes. Laws which permit these taxes to be withheld from Federal civilian pay prohibit such withholding from military pay. (See ch. 2.)

Thirty-five States and the District of Columbia tax the pay of military personnel. With the help of the District and Maryland, GAO made tests to see if military personnel were having problems meeting their District and Maryland income tax obligations without withholding. A more limited test was made to see if there were similar problems in other States.

Overall, the tests indicated that about 45 percent of 201 personnel checked by the District and Maryland were not on record as having filed tax returns that appear to have been required. The test in other States indicated the presence of the problem but was inconclusive on its extent. (See p. 8.)

GAO did not expand its tests because in June 1974 the National Association of Tax Administrators (an association of State tax officials) unanimously decided to inform the Federal Government of the States' desire that State income taxes be withheld from military pay.

State tax administrators said widespread non-compliance by many members of the armed services with State income tax filing requirements was creating difficulties for both service personnel and for the States. Revenue losses were also becoming increasingly significant. (See p. 8.)

The Department of Defense does not favor withholding State income taxes from military pay. The Office of Management and Budget, however, believes such withholding would be beneficial to military personnel and jurisdictions alike and therefore should be permitted. (See ch. 6.)

Defense cited administrative difficulties and implementation costs as its principal objections. GAO recognizes it would cost the Federal Government to withhold State income taxes from military pay but points out that similar withholding is being done with respect to civilian employees by Federal agencies and by private firms having operations national in scope.

Moreover, withholding State income taxes from military pay would have overriding benefits. Service personnel would find it easier to meet their tax obligations, and the States would realize increased tax revenues and reduced administrative costs of tax law enforcement.

The Federal Government provides billions of dollars to State and local governments to help finance their programs; therefore, it has an interest in helping these jurisdictions maximize the yield from their revenue sources. In view of the magnitude of the compliance problems (as indicated by its tests and by State tax officials), GAO believes the Federal Government should permit withholding from military pay. (See ch. 7.)

As an alternative, or as an interim measure until an efficient withholding system can be developed, the services could permit their personnel to make payroll allotments for paying State income taxes. At present, voluntary payroll allotments are permitted for many other purposes. However, the taxing jurisdictions would have to agree to an allotment procedure.

This report, together with the views of the Federal agencies concerned, should assist the Congress in considering S. 556, H.R. 9075, H.R. 9519--all introduced in the 94th Congress, 1st session--or any other proposals for withholding income taxes from military pay.

It also may assist the Congress in considering recommendations of the Advisory Commission on Intergovernmental Relations for amending the Federal law which places certain restrictions on States in taxing military pay. (See ch. 5.)

Either of the House bills, if passed, would provide adequate authority for withholding State and District income taxes from military pay. (See p. 19.)

CHAPTER 1

INTRODUCTION

To enable taxpayers to pay their income taxes on a current basis, legislation was enacted in 1943 requiring employers to withhold Federal income taxes from their employees' salaries and wages. Since that time, the District of Columbia and most States levying individual income taxes have also instituted withholding. Adoption of withholding has been credited with increasing tax revenues by as much as 25 percent. Payroll deductions make it easier for taxpayers to meet their tax obligations.

In reviewing compliance with the District's individual income tax laws, we noted that, pursuant to Federal law, the pay of a very large group of Federal employees--members of the armed services--was not subject to withholding of income taxes of the District or of any State. 1/ The pay of these employees in fiscal year 1976 is estimated to total \$17 billion.

We wanted to find out if members of the armed services had problems meeting their obligations for income taxes that cannot be withheld from their pay.

SCOPE OF REVIEW

With the assistance of the District and Maryland, we tested compliance by military personnel with District and Maryland tax filing requirements and, to a limited extent, with tax filing requirements of other States. The District made the necessary contacts with other States.

We reviewed documents relating to filing requirements of individual income tax laws of the States and the District and the legislative history of withholding of State and city taxes from Federal employees' pay. We discussed our review with officials of the District of Columbia, Maryland, Virginia, the Office of Management and Budget, the Department of Defense (DOD), and the Department of the Treasury.

1/Whenever the term "States" is used in this report, it applies also to the District of Columbia.

CHAPTER 2

PAY-AS-YOU-GO PRIVILEGES

FOR STATE INCOME TAXES

NOT AVAILABLE TO MEMBERS OF ARMED SERVICES

Members of the armed services are not accorded the pay-as-you-go privileges for State income taxes available to other Federal employees. "Pay-as-you-go" can be accomplished by tax withholding or voluntary allotments from salaries.

WITHHOLDING OF STATE AND CITY INCOME TAXES FROM FEDERAL PAY

Pursuant to authority contained in sections 5516, 5517, and 5520 of subchapter II, chapter 55, title 5, United States Code, the Secretary of the Treasury enters into agreements with the District, States, and cities to withhold taxes from Federal employees' pay. The agreements cannot apply to members of the armed services.

Authority to withhold State income taxes from Federal pay was provided by the Act of July 17, 1952, chapter 940, Public Law 587 (66 Stat. 765). Authority for District income tax withholding from Federal pay was added by the District of Columbia Revenue Act of 1956 (70 Stat. 77), approved March 31, 1956; withholding of city income or employment taxes was authorized by Public Law 93-340 (88 Stat. 294), approved July 10, 1974.

The legislative history of the Act of July 17, 1952, indicates that military pay was to be excluded from withholding agreements for State income taxes because the House Committee on Ways and Means believed that including it would cause serious administrative problems since service in the Armed Forces at particular locations is frequently temporary or transient.

The legislative histories of the District Revenue Act of 1956 and Public Law 93-340 contained no reasons for excluding military pay from these withholding authorizations; however, in its comments on Public Law 93-340, the Office of Management and Budget stated that military personnel should also be accorded withholding privileges.

The legislative history of Public Law 93-340 also contained a cross section of current views from other agencies, the Congress, and tax administrators regarding the benefits of the Federal Government's withholding of taxes for other taxing jurisdictions. These same benefits would apply to withholding taxes from military pay. Examples follow.

"At a time when Congress is making huge grants of Federal funds to solve urban problems, approval of mandatory withholding of municipal wage taxes would seem to us a logical step."

"Passage of this legislation would also be another example of Federal Government cooperating with local government and helping them to help themselves."

"Absence of a withholding requirement works a great hardship on Federal employees who are liable for such taxes, because they must establish individual accounts, file periodic returns (usually quarterly), and accumulate funds to meet this periodic obligation. As a result, many become delinquent and are faced with the additional expense of penalties and interest. Many never pay the tax."

"I personally have talked with literally thousands of Federal employees, with their union representatives and the heads of most agencies. Without exception all have favored passage of this legislation, so that they would not be burdened with a lump-sum payment each year. They cannot understand why items such as Blue Cross, union dues, et cetera, can be withheld, but a legitimate tax cannot."

VOLUNTARY PAYROLL ALLOTMENTS

Pursuant to 37 U.S.C. 701-706, the armed services can permit their personnel to make pay allotments--regular deductions for payments to designated payees--for purposes authorized by DOD.

At present, the services permit their members to make allotments for such purposes as purchase of U.S. savings bonds, repayment of certain loans, support of dependents, payment to a banking institution for savings, voluntary liquidation of debts to the United States--including delinquent Federal income taxes--payment of pledges for combined Federal campaigns, and payment of life insurance premiums. Allotments for voluntary withholding of State income taxes are not authorized by DOD.

Under the allotment procedures, a member would annually estimate his State income tax and request that it be deducted in equal installments from his pay and paid to the State he designates.

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We have reviewed three bills introduced in the 1st session of the 94th Congress to permit withholding of State and local income taxes from the pay of members of the Armed Forces. These bills are S. 556, introduced in February 1975 and referred to the Senate Committee on Finance; H.R. 9075, introduced in July 1975 and referred to the House Committee on Armed Services; and H.R. 9519, introduced in September 1975 and referred to the House Committee on Ways and Means. The Senate bill pertains only to State (not including the District) income tax withholding while both the House bills pertain to State and city taxes.

CHAPTER 3

TESTS INDICATE MILITARY PERSONNEL

HAVE PROBLEMS MEETING THEIR TAX OBLIGATIONS

With the assistance of the District of Columbia and Maryland, we conducted two tests to find out if members of the armed services had problems meeting their District and Maryland tax obligations without withholding. The tests indicated there were significant problems. Since the tests involved only two jurisdictions, however, the results should not be used as a measure of how well all military personnel discharge these obligations.

A third, more limited test indicated that the compliance problem shown by the District and Maryland tests probably was present in other jurisdictions, but the results of this test are inconclusive as to the extent of the problem.

We did not expand our tests to determine the extent of the problem in other States because a meeting of State tax administrators subsequently confirmed that the problem was widespread. (See p. 8.)

TEST USING W-2 INFORMATION

The armed services, in complying with a requirement of Office of Management and Budget Circular No. A-38, 1/ provided information on members' earnings to States the members claimed as their legal residences. The services sent the States informational copies (or computerized versions, if requested) of Forms W-2. 2/ Service procedures provided that Form W-4 3/ be used to obtain a declaration of legal residence (see ch. 5) from each member and be the basis for sending information to the States. If a current W-4 did not appear in a serviceman's record, the informational statement of earnings was sent to the State where he was serving. In accordance with the Circular, the services did not give States information on military personnel assigned overseas.

At our request, the District and Maryland selected informational W-2s received from the services and checked

1/On September 25, 1975, the Office of Management and Budget rescinded A-38. This action is discussed on page 16.

2/Statement of earnings and tax withholdings.

3/Employees' withholding exemption certificate.

them against individual income tax returns on file. For those military personnel who did not have returns on file with the District or Maryland, the District made additional followup, on the basis of information we developed, to find out if they filed with other States.

The results of this test follow.

	<u>Number</u>	<u>Percent</u>
Of individuals selected:		
Filed with District or Maryland	39	30.2
Filed with another State shown on W-4 or otherwise indicated as legal residence	7	5.4
State of legal residence shown on W-4 or otherwise indicated either does not impose an individual income tax or fully exempts military pay	6	4.7
Filed in State where serving	10	7.8
Had not filed return with District or Maryland that appears to have been required	<u>67</u>	<u>51.9</u>
Total	<u>129</u>	<u>100.0</u>

ABSENTEE VOTER TEST

Legal residents of the District who are absent from the District may register and vote absentee. The District of Columbia Board of Elections said it received about 7,000 applications for absentee ballots for the 1972 Presidential election and that military personnel were a major group that filed for absentee ballots.

We selected 72 military personnel from the Board's 1972 file of absentee voter applications and provided their names and other available information to the District's Department of Finance and Revenue. The Department ascertained from its records if individual income tax returns had been received from these individuals for 1972 and followed up on those individuals who had not filed returns.

	<u>Number</u>	<u>Percent</u>
Names submitted:		
Return on record	19	26
Not liable	1	1
Inquiry returned for insufficient address	20	28
No response to followup	7	10
Liable and filed after followup	<u>25</u>	<u>35</u>
Total	<u>72</u>	<u>100</u>

FEDERAL-STATE TAPE EXCHANGE
PROGRAM FOLLOWUP TEST

Under this Program, which has been used by 45 States and the District, the Internal Revenue Service annually (or less frequently, if requested) provides users magnetic tape data on individuals who filed Federal tax returns. This data is provided on the basis of addresses on Federal tax returns. The users can match the data against data from individual income tax returns to identify persons who did not file State returns (mismatches). Because the addresses shown on Federal tax returns do not always indicate the jurisdiction to which individuals are liable for income tax, users must follow up on mismatches to determine liability and to obtain compliance.

At our request, the District and Maryland selected samples from military personnel responding to Program inquiries who said they had not filed returns with the District or Maryland because they were legal residents of other States. The samples were consolidated according to the States claimed as legal residences, and the District checked the individuals' filing status with the States.

The results provided us by the District follow.

	<u>Number</u>	<u>Percent</u>
Responses sampled:		
Claimed State which exempted service pay or had no individ- ual income tax	23	40
Filed in State claimed as legal residence	15	26
Did not file with State claimed as legal residence	<u>19</u>	<u>34</u>
Total	<u>57</u>	<u>100</u>

Although the Program test indicated that some of the personnel involved were not complying with the income tax laws of other States, it should not be used as a measure of this problem. Besides the fact that the sample was very small, 8 of the 19 nonfiling cases involved States which do not exempt military pay outright but provide that under certain conditions legal-resident military personnel will be granted nonresidency status for income tax purposes. These conditions are that the personnel do not maintain permanent places of abode or spend more than a certain amount of time in the States during the year and that they maintain permanent places of abode in other States. Generally, military housing on a Government installation is not considered a permanent place of abode. The status of each individual is determined on the basis of a review of the facts involved. (See p. 11.)

Two other cases of apparent noncompliance involved a State which exempts all military pay but requires that military personnel file returns.

SUMMARY OF TESTS

Overall, 92, or about 45 percent, of 201 individuals included in the tests using W-2 information and absentee voter applications were not on record as having filed tax returns with the District or Maryland that appear to have been required. The Federal-State Tape Exchange Program test indicated that the problem also existed in other States.

The jurisdictions did not contact the potential nonfilers identified for the tests using Federal-State Tape Exchange Program and W-2 information to ascertain their liability for tax. From an income standpoint, the data available on these individuals indicated that some tax payment would have been required. For the absentee voter test, the District had to contact the individuals involved to determine if a tax return should have been filed because no income data was available for them.

We did not expand our tests because in June 1974 the National Association of Tax Administrators ^{1/} unanimously decided to inform the Federal Government of the States' desire that State income taxes be withheld from military pay. Meeting in Portland, Oregon, the Association adopted a resolution stating that (1) noncompliance with State income tax filing requirements is widespread among members of the Armed Forces,

^{1/}The objective of the Association, of which the District is a member, is to improve State tax administration. The States are represented by officials from their tax departments.

(2) this noncompliance is creating difficulties for both these taxpayers and for State tax administrators, and
(3) revenue losses are becoming increasingly significant.

The Association's resolution said individual States cannot obtain the high level of compliance from members of the Armed Forces that is obtained from other taxpayers. The reasons cited were the large volume of members having potential tax liability, their mobility, and the difficulty in locating and obtaining their tax returns and collecting any taxes due.

The resolution concluded that withholding State income taxes would make it easier for military personnel to meet their tax obligations, increase the overall equity of the taxes, and reduce present administrative difficulties in obtaining compliance with State income tax laws. The executive secretary of the Association was directed to advise the appropriate officials of the executive branch of the Federal Government and the Congress of the States' desire that State income taxes be withheld from the pay of members of the Armed Forces.

At its June 1975 annual meeting in St. Louis, the Association reaffirmed the States' desire.

At the 1975 meeting, the chief of the Income and Sales Tax Divisions of the Mississippi Tax Commission reported that he had made a survey which revealed that, on the average, States had not reached a 50-percent level of compliance among military personnel.

CHAPTER 4

VARIATIONS IN STATE TAXATION OF MILITARY PAY

At present 41 States tax individual income. Generally, States impose income taxes on (1) individuals who reside or are domiciled in the States during the tax year, regardless of the sources of their income, and (2) nonresidents who derive income from sources within the States.

Active military personnel are not excused or exempt from State income tax liability unless the State law so provides. The extent to which the States include military pay in their definitions of taxable income varies somewhat. According to the "All States Income Tax Guide" published by the office of the Judge Advocate General, U.S. Air Force, 24 States include all military pay in taxable income except pay received while in a combat zone. Seventeen States exempt some or all service pay.

The following summary is based on information contained in the "All States Income Tax Guide."

States Which Do Not Exempt Military Pay (24)

Alabama	Mississippi
Colorado	Missouri
Delaware	Montana
District of Columbia	Nebraska
Georgia	New Mexico
Hawaii	New York
Kansas	North Carolina
Kentucky	Ohio
Louisiana	Rhode Island
Maine	South Carolina
Maryland	Utah
Massachusetts	Virginia

States Which Exempt Some or All Service Pay (17)

Alaska (note a)	Michigan (note a)
Arizona (note b)	Minnesota (note b)
Arkansas (note b)	North Dakota (note b)
California (note c)	Oklahoma (note b)
Idaho (note d)	Oregon (note b)
Illinois (note a)	Pennsylvania (note d)
Indiana (note b)	Vermont (note a)
Iowa (note a)	West Virginia (note b)
	Wisconsin (note b)

States Not Having Individual Income Tax (10)

Connecticut (note e)	South Dakota
Florida	Tennessee (note f)
Nevada	Texas
New Hampshire (note g)	Washington
New Jersey (note h)	Wyoming

In 10 States which exempt a certain amount of military pay, the amounts exempted range from \$1,000 (Arizona, California, North Dakota, and Wisconsin) to \$6,000 (Arkansas). In several of these States, the amounts depend on the location of the member's duty station. For example, in Minnesota, \$3,000 of service pay is exempt if the member is stationed within the State; \$5,000 is exempt if the member is stationed outside the State.

In 4 of the 24 States which do not exempt any military pay and in 2 of the 10 States with partial pay exemptions,

a/All service pay exempted.

b/Partially exempted.

c/Exempted in full if stationed outside State; partially exempted if stationed within State.

d/Exempted in full if stationed outside State; taxable in full if stationed within State.

e/Tax on capital gains.

f/Tax on interest and dividends.

g/Tax on interest and dividends and commuter tax.

h/New York commuter tax and surcharge.

residency definitions provide legal-resident military personnel nonresidency status for income tax purposes if they did not maintain a permanent place of abode or spend more than a certain amount of time in the States during the year and if they did maintain a permanent place of abode in another State. Generally, military housing on a Government installation is not considered a permanent place of abode. The status of each individual must be determined by a review of the specific facts involved.

CHAPTER 5

LEGAL RESIDENCE OF MILITARY PERSONNEL UNDER THE SOLDIERS' AND SAILORS' CIVIL RELIEF ACT

Pursuant to section 514 of the Soldiers' and Sailors' Civil Relief Act of 1940, as amended, military personnel may maintain legal residence in States other than the States where they live.

Section 514 provides that a member of the military service does not lose his legal residence in a State when moved by military order to another State. The underlying rationale for section 514 is that service personnel are a highly mobile and transient population who might, under some circumstances, find their service pay subject to the income taxes of more than one State. Section 514 eliminates this possibility by prohibiting any State other than the one claimed by a military member as his permanent legal residence from taxing his military pay.

As more and more States have enacted individual income tax laws, safeguards against double taxation have been provided. These have included credits for taxes paid to other States and reciprocal agreements for taxing the incomes of individuals who regularly commute to work across State boundaries.

In February 1975 the Advisory Commission on Intergovernmental Relations 1/ began to assess the Relief Act's relevancy to the current possibilities for double taxation of service personnel. The Commission has concluded that military active duty pay should be taxable under the same jurisdictional rule as applies to all other forms of compensation.

In September 1975 the Commission voted to recommend to the Congress that the Soldiers' and Sailors' Civil Relief Act be amended to remove the stipulation that only a service member's State of domicile (legal residence) can tax his active duty military pay. The Commission also recommended that a State having a domicile jurisdictional rule retain authority to tax the military pay of its legal residents but that it allow a credit against its tax for taxes paid on the same income to another State.

1/A permanent Commission created by the Congress to examine Federal, State, and local government problems. Its members are drawn from private citizens, the Congress, the Federal Executive Branch, State governors, State legislators, elected county officials, and elected city officials.

CHAPTER 6

AGENCY COMMENTS AND OUR EVALUATION

In August 1975, DOD and the Office of Management and Budget commented on providing military personnel pay-as-you-go privileges for State income taxes.

DOD COMMENTS

DOD expressed willingness to cooperate with the States to the fullest practicable extent, short of withholding, to get its military members to comply with applicable State income tax laws. DOD said that unless State laws applying to military pay were made sufficiently uniform, the administrative difficulties and costs of withholding would very likely outweigh the advantages to members, the States, and the Federal Government.

The principal comments of DOD regarding withholding and our evaluation of them follow.

"Unfortunately there are 29 variant sets of withholding tax regulations among the States that have income tax laws applicable to members of the military. For some States, withholding is based on tables; for some, it is based on a percentage of gross pay; and for others, it is based on a percentage of Federal income tax withheld. The percentage and table break points vary greatly from State to State as do exemptions by reason of service in the military. Further, marital status and number of exemptions for dependents have different effects in each State. * * *

"Frequent changes in State tax law provisions would have to be monitored and maintained current and for many individual reassignments it would require re-examination of the rate of tax. These requirements would significantly increase administrative workloads. * * *"

Federal agencies withhold State income taxes from their employees' pay in accordance with agreements that have been entered into between the Secretary of the Treasury and the States. We understand that most States (28) have entered into a standard agreement with the Treasury which permits the method of calculating the tax withheld to be at the discretion of the Federal agencies as long as the tax approximates the employees' liability. Under this agreement, the agencies do not have to precisely follow State withholding

tables but they do have to keep abreast of the State tax requirements. Similar arrangements could be made with the States for withholding taxes from military pay.

Withholding income taxes for many different jurisdictions is not something unique to the Federal Government. Many private businesses with nationwide operations do likewise. A recent survey by the State of Maryland showed that 12 such firms withheld, on the average, taxes for 22 State governments and 70 local governments.

Although withholding does place administrative burdens on employers, it is the most effective means of insuring payment of income taxes. Equally important, it provides individuals with a convenient way to pay their taxes on a current basis.

DOD also said that:

"* * * withholding for State income taxes would require major redesign and reprogramming efforts with respect to computerized pay systems of the Services. The Navy, having unique problems with regard to those serving on sea duty, is still in the process of implementing the computerized Joint Uniform Military Pay System for active duty personnel. The Army is also in the process of implementing the computerized pay system for its reserve components. Without the assistance of computerization, it would be virtually impossible to implement the variant State withholding procedures. With computerization, it would be exceedingly difficult and expensive. It is estimated that implementation of withholding systems by all services would require from 24 to 30 months.

"The Services roughly estimated total development costs for State income tax withholding at \$9.9 million. Annual maintenance of the system is estimated at \$4.7 million for all Services. [GAO note: DOD subsequently revised these estimates to \$6.3 million and \$1.7 million, respectively.] Such costs would not generate any additional tax revenue for the Federal tax base. Instead, they would represent an increase in DOD budgetary requirements. Given today's budgetary realities, it is not believed such costs should be incurred without the individual States and DOD first exploring all feasible alternatives and making every effort to gain compliance through less costly means."

DOD estimates indicate the implementation of withholding systems by all services would require substantial time and money. As alternatives, DOD suggested that it would (1) improve the W-2 information it sends to States pursuant to Office of Management and Budget Circular A-38 to facilitate the States' followup on military personnel who do not fulfill their tax obligations and (2) review its efforts to inform members of State and local tax obligations and increase these efforts if necessary.

DOD has tried to apprise military members of their rights and obligations under State and local tax laws. (See app. II.) While this effort has been commendable and, no doubt, helpful to service members, we found that many still have problems meeting their State income tax obligations.

Although more effort by DOD to counsel members and help the States follow up on personnel who are having problems meeting these obligations might help, the turnover in military service (hundreds of thousands of new recruits each year) would require a continuing, undeterminable investment of both State and DOD administrative resources in this area. Withholding would greatly reduce this burden. Therefore, the expense to the Federal Government of withholding State income taxes from military pay would be somewhat offset by the administrative savings made possible.

After DOD's comments, the Office of Management and Budget rescinded A-38 because it determined that providing information on Federal employees' earnings to State and local jurisdictions was not authorized by the Privacy Act of 1974 (Public Law 93-579). In announcing the rescission, the Office of Management and Budget said it was searching for alternative means to provide similar tax-related information through existing authorities of the Federal agencies.

Even if the flow of military pay information to the States is resumed, this approach to helping service members meet their tax obligations is not as desirable for the members, the States, or the Federal Government as withholding.

The Federal Government withholds State and local income taxes from civilian pay not only to aid State and local tax administration but also to help its civilian employees avoid tax delinquency.

It would be difficult to find an area of Federal service which deserves the convenience withholding affords more than the military service with its inherent demands on members. At the September 1975 Advisory Commission on Intergovernmental Relations hearings on State and local taxation of military

personnel, the Deputy Assistant Secretary of Defense for Military Personnel Policy described military service as follows:

"* * * members have no choice but to comply with military movement orders, they are subject to duty 24 hours a day if need be, without overtime pay, they are subject to courts martial for disobeying lawful orders, they are subject to periodic family separations while serving on unaccompanied or hardship tours or while on sea duty, junior enlisted personnel cannot send their dependents and household goods at Government expense to new assignments * * *."

Considering the importance of this kind of commitment, we cannot conclude that the administrative difficulties and costs cited by DOD should prohibit extending to military personnel the pay-as-you-go privileges for State income taxes that are already accorded other Federal employees to help them meet their tax obligations and avoid tax delinquency.

OFFICE OF MANAGEMENT
AND BUDGET COMMENTS

The Office said:

- The present system of withholding State and local taxes from the pay of Federal civilian employees has definitely proved to be beneficial both to the employees and to the States and local municipalities by making it easier for individuals to meet their tax obligations and easing jurisdictions' receipt of revenues.
- Because similar benefits would accrue if a withholding system was applied to military pay, the Federal Government should assure that such a system is developed and implemented.
- A-38 might be rescinded. (It subsequently was.) Rescission or limitation of A-38 would mean that States and local jurisdictions would not have any ready access to payroll information on military personnel.

CHAPTER 7

CONCLUSIONS AND MATTERS FOR CONSIDERATION BY THE CONGRESS

CONCLUSIONS

Extending to members of the armed services the pay-as-you-go privileges for State income taxes provided other Federal employees is in the best interests of the members and the taxing jurisdictions. Since the Federal Government provides billions of dollars to State and local governments to help finance their programs, it can benefit from helping these jurisdictions maximize the yield from their taxes.

DOD's arguments against withholding State income taxes from service personnel centered around the administrative burden withholding would cause the Federal Government due to the temporary and transient nature of service duty and the variations in State income tax laws applicable to service pay. DOD estimated it would take 24-30 months to implement withholding of State income taxes from military pay and that it would cost \$6.3 million initially and \$1.7 million annually.

We recognize that it would cost the Federal Government to withhold State income taxes from military pay but point out that similar withholding is being done with respect to civilian employees by Federal agencies and private firms having operations national in scope.

Withholding applicable State income taxes from military pay would have overriding benefits. Service personnel would find it easier to meet their tax obligations, and the States would realize increased tax revenues and reduced administrative costs of tax law enforcement. In view of the magnitude of the compliance problem indicated by our tests and by the National Association of Tax Administrators, the Federal Government should extend to the States and service personnel the benefits of withholding from military pay.

If, as DOD has said, the armed services need 2 years to implement the withholding of State income taxes, it may be helpful, in the interim, to permit service personnel to make pay allotments for this purpose if the taxing jurisdictions agree. If the Congress decides not to authorize withholding, the voluntary allotment procedure could be adopted as an alternative.

MATTERS FOR CONSIDERATION BY THE CONGRESS

In view of the prohibitions contained in 5 U.S.C. 5516 and 5517, the Congress will have to enact legislation to allow tax withholding agreements between the Secretary of the Treasury and applicable taxing authorities to include the pay of members of the armed services.

As an alternative, or as an interim measure until an efficient withholding system can be developed, the Congress may wish to have the armed services permit service personnel to make payroll allotments for paying State income taxes on a current basis. However, the taxing jurisdictions would have to agree to such a procedure.

This report, together with the views of the Federal agencies concerned, should assist the Congress in considering S. 556, H.R. 9075, H.R. 9519, or any other proposals for withholding income taxes from military pay. It may also assist the Congress in considering recommendations of the Advisory Commission on Intergovernmental Relations for amending the Soldiers' and Sailors' Civil Relief Act.

Either of the House bills, if passed, would provide adequate authority for withholding State and District income taxes from military pay; however, the bills should contain language amending sections 5516 and 5517 of title 5, United States Code, to delete the statements that agreements to withhold State and District income taxes from Federal pay may not apply to pay for service as a member of the Armed Forces.



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

AUG 12 1975

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

Dear Mr. Lowe:

The Director of the Office of Management and Budget has asked me to respond to your letter of June 13, 1975 in which you requested comments on a draft of a proposed report to the Congress on a case for providing pay-as-you-go privileges to military personnel for state and local income taxes.

There is no question that the present system of withholding state and local taxes from pay of Federal civilian employees has proved to be beneficial both to the employee and to the states and local municipalities. This system makes it easier for individuals to meet their tax obligations and it also facilitates the receipt of revenues that appropriately belong to the affected states. We believe similar benefits would be forthcoming if such a withholding system was applied to military pay and that the Federal Government should provide whatever assistance is necessary to assure that such a system is developed and implemented.

Your report identifies several problems which must be dealt with in order to develop a system which protects the military member, assists him in meeting his tax obligations and at the same time assure that states and localities can collect the taxes due them. Your suggestion that as an alternative or as an interim measure the Congress should consider having the military services make use of payroll allotments is worthy of further study.

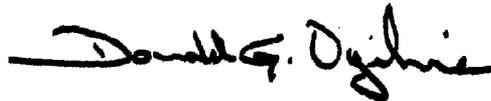
We would expect to continue a review of your suggestions as well as others which might assist in resolving this problem. We are certain that your report and its findings,

as well as deliberations by Governmental agencies of the merits of Senate Bill 556, will assist in arriving at a proposal which will benefit both military personnel and the state and localities.

At the same time OMB is analyzing implications of the Privacy Act on Circular A-38. In a recent advisory, the Justice Department stated that the propriety of providing payroll information to state and local jurisdictions which have no withholding agreement may be dubious under the Act. If a determination is made that the Privacy Act does in fact prohibit disclosure of payroll information, A-38 may have to be rescinded or modified so significantly that it might be rendered virtually useless (the Act provides criminal sanctions against individual Federal employees and officials who willfully fail to comply with the Act). Rescission or limitation of A-38 would mean that state and local jurisdictions would not have any ready access to payroll information on military personnel since withholding is not presently authorized for the military.

Thank you for the opportunity to express our views on your draft report.

Sincerely,



Donald G. Ogilvie
Associate Director



ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

MANPOWER AND
RESERVE AFFAIRS

August 15, 1975

Mr. Forrest R. Browne
Director, Federal Personnel and
Compensation Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Browne:

The Secretary of Defense has asked us to respond to your letter of June 13, 1975 in which you invited comments on a draft of a proposed report to the Congress on a case for providing pay-as-you-go privileges to military personnel for State and local income taxes.

On behalf of the Department of Defense, we wish to express appreciation to you and your staff for the fair and unbiased treatment of the subject matter contained in the draft report.

One of the relevant aspects not addressed in the draft report is the fact that it has long been DoD policy that our military members comply with tax obligations that might apply to them, whether Federal, State or local. However, because of the provisions of 5 U.S.C. 5517, which prevent the Secretary of the Treasury from entering into agreement with any State for the withholding of State income taxes from military pay, compliance is thus a matter that rests largely between the individual member and the State claimed as his legal domicile. Nevertheless, this Department makes every effort to apprise all of our military members of their rights and obligations with respect to State and local tax laws through numerous internal publications and other information channels. Enclosed is a listing of representative publications and other media means used in this continuing information and education effort.

With respect to any proposal which would require withholding for State income taxes from military pay, there are significant problems attendant thereto. In considering the bill which was later to become codified as



5 U.S.C. 5517, the House Ways and Means Committee stated in its report that "Your committee believes that to extend the authorization contained in this bill into this area would create serious administrative problems in view of the fact that service in the Armed Forces may frequently be of a temporary nature or may be transient in character." In 1952, when this law was enacted, there were 34 States which had some type of income tax laws; today there are 43.

Unfortunately, there are 29 variant sets of withholding tax regulations among the States that have income tax laws applicable to members of the military. For some States, withholding is based on tables; for some, it is based on a percentage of gross pay; and for others, it is based on a percentage of Federal income tax withheld. The percentage and table break points vary greatly from State to State as do exemptions by reason of service in the military. Further, marital status and number of exemptions for dependents have different effects in each State. These are but a few factors which would complicate withholding for State income taxes.

Frequent changes in State tax law provisions would have to be monitored and maintained current and for many individual reassignments it would require reexamination of the rate of tax. These requirements would significantly increase administrative workloads. Further, withholding for State income taxes would require major redesign and reprogramming efforts with respect to computerized pay systems of the Services. The Navy, having unique problems with regard to those serving on sea duty, is still in the process of implementing the computerized Joint Uniform Military Pay System for active duty personnel. The Army is also in the process of implementing the computerized pay system for its reserve components. Without the assistance of computerization, it would be virtually impossible to implement the variant State withholding procedures. With computerization, it would be exceedingly difficult and expensive. It is estimated that implementation of withholding systems by all Services would require from 24 to 30 months.

The Services roughly estimate total development costs for State income tax withholding at \$9.9 million. Annual maintenance of the system is estimated at \$4.7 million for all Services. Such costs would not generate any additional tax revenue for the Federal tax base. Instead, they would represent an increase in DoD budgetary requirements. Given today's

budgetary realities, it is not believed such costs should be incurred without the individual States and DoD first exploring all feasible alternatives and making every effort to gain compliance through less costly means.

[See GAO note, p. 26.]

[See GAO note, p. 26.]

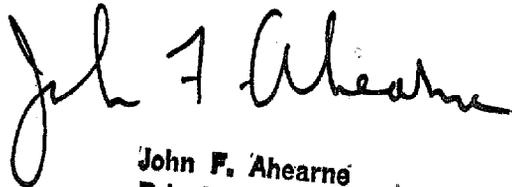
It should be noted that the comments contained herein on the issue of withholding for State income taxes from military pay are not inconsistent with the Department of Defense report on S. 556, a bill "To permit withholding of State income taxes from compensation of members of the Armed Forces."

In conclusion, I wish to reiterate this Department's willingness to cooperate with the States to the fullest practicable extent, short of withholding, to

effect compliance of our military members with applicable State income tax laws. Without a change in these laws to provide for a significant degree of uniformity, the administrative difficulties and costs of withholding would very likely outweigh the advantages to our members, the States and the Federal Government. Nevertheless, in an effort to be of assistance to the States, the Military Departments have been requested to (1) take prompt action to insure that wage statements filed with the States are complete as to individual addresses, (2) begin preparation to be able to file wage statements with the States on members serving overseas or on sea duty, (3) again determine the suitability of permitting voluntary allotments from military pay to meet State tax obligations, to include a means to protect our members by providing them withholding information to file with State tax returns, and (4) review continuing information and education efforts to advise members of State and local tax obligations and increase these efforts if necessary. I trust these initiatives will achieve results that will benefit both our members in the military and the States.

Thank you for the opportunity to express the views of the Department of Defense on your draft report.

Sincerely,



John F. Ahearn
Principal Deputy

Enclosure

GAO note: Comments pertaining to draft report material revised in the final report or to matters not germane to the report have been omitted.

Information Concerning State Income Tax Liability

The following publications are representative samples of the information which is provided to military personnel concerning the obligation to pay State and local income taxes.

DoD Information Guidance Series

Number 8A-18 Feb. 1975 STATE INCOME TAXES LIABILITY

Number 8A-22 (Rev) Feb. 1975 FEDERAL TAX BENEFITS

These items are published by the Office of Information for the Armed Forces and released in bulk to the Military Departments for distribution through both information and command channels worldwide. These examples were published originally in 15,000 copies and are intended for local reproduction. Future publication of these items will be increased to approximately 75,000 copies.

Copies are provided directly to over 2,000 base newspapers worldwide through the American Forces Press Service and to all network stations of the American Forces Radio and Television Services overseas. This information is reproduced locally in the base newspapers and forms the basis for spot announcements on radio and television broadcasts. These items are provided to Stars and Stripes overseas and the Army Times Publishing Company which publishes the highly popular and well read Army, Navy, Air Force and Federal Times weekly newspapers.

Armed Forces Press Service

Several releases made in early 1975

These publications are provided on a regular basis for use by editors of over 2,000 base newspapers. Although total circulation of such newspapers is not known (many are civilian enterprise papers not published at government expense) the general experience indicates that publishers print one copy for every three members of the local military community (i. e., active duty personnel, civilian employees, retirees and dependents).

Army Times

February 19, 1975

This article appeared in the commercial publications of the Army Times Publishing Company. Total circulation of the Army, Navy, and Air Force Times is currently reported to be 410,000 copies weekly.

All States Income Tax Guide

This publication is prepared by the Office of the Judge Advocate General, of the Air Force and is distributed (4,000 copies) to legal assistance officers and unit income tax officers worldwide. It is utilized by all Services. This year 1,200 copies were provided for use in the unit income tax officers training schools conducted by the IRS under Army sponsorship in overseas areas.

JAG Instruction 5840.6E "State and Local Income Taxes"

Published by the Office of the Judge Advocate General of the Navy this item is distributed to all ships and stations of the Navy and all Marine Corps units worldwide. It was published in 13,000 copies.

Legal Assistance Newsletter 75-1

Published by the Office of the Judge Advocate General of the Navy, and provided to all legal assistance officers, this letter illustrates a typical method whereby State tax information is distributed to legal assistance offices.

Local Laws Affecting Military Personnel

This pamphlet is a tri-Service publication distributed to military personnel upon assignment to the Washington area. Similar publications are provided to newly assigned personnel at most major military installations both in the U. S. and overseas.

Military Personnel Information Bulletin

This item provided to OSD personnel is typical of locally prepared unit personnel bulletins which not only provide a service to assigned personnel, but also serves as a reminder of the responsibility.

The Pentagon News March 6, 1975 and January 30, 1975

The Pentagon News is an example of a private enterprise newspaper (supported by private advertisers) which is distributed free at all U. S. Army installations in the Military District of Washington.

The Boot February 8, 1974

The Boot is published with nonappropriated funds and distributed (6,000 copies) without cost to Marine Corps personnel at the USMC Recruit Depot, Parris Island, South Carolina. (Mail subscriptions cost \$3.00 per year.)
The Boot is typical of the 2,000 base newspapers which belong to the Armed Forces Press Service.

Commanders Digest

Vol. 17, No. 5, January 30, 1975

This publication is circulated world-wide to 80,000 military commanders and their key staff officers. Volume 17 was devoted entirely to State income taxes.

Copies of GAO reports are available to the general public at a cost of \$1.00 a copy. There is no charge for reports furnished to Members of Congress and congressional committee staff members; officials of Federal, State, local, and foreign governments; members of the press; college libraries, faculty members, and students; and non-profit organizations.

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