



State Taxation of Military Income and Store Sales

**ADVISORY COMMISSION ON
INTERGOVERNMENTAL RELATIONS**

Washington, D.C. 20575 • July 1976

A-50

COMMISSION MEMBERS

(MARCH 1976)

PRIVATE CITIZENS

Robert E. Merriam, Chairman, Chicago, Illinois
John H. Altorfer, Peoria, Illinois
F. Clifton White, Greenwich, Connecticut

MEMBERS OF THE UNITED STATES SENATE

Ernest F. Hollings, South Carolina
Edmund S. Muskie, Maine
William V. Roth, Delaware

MEMBERS OF THE U.S. HOUSE OF REPRESENTATIVES

Clarence J. Brown, Jr., Ohio
L. H. Fountain, North Carolina
Richard Vander Veen, Michigan

OFFICERS OF THE EXECUTIVE BRANCH, FEDERAL GOVERNMENT

James T. Lynn, Director, Office of Management and Budget
James M. Cannon, Assistant to the President for Domestic Affairs
Carla A. Hills, Secretary, Department of Housing and Urban Development

GOVERNORS

Daniel J. Evans, Washington
Richard F. Kneip, South Dakota
Philip W. Noel, Rhode Island
Otis R. Bowen, M.D., Indiana

MAYORS

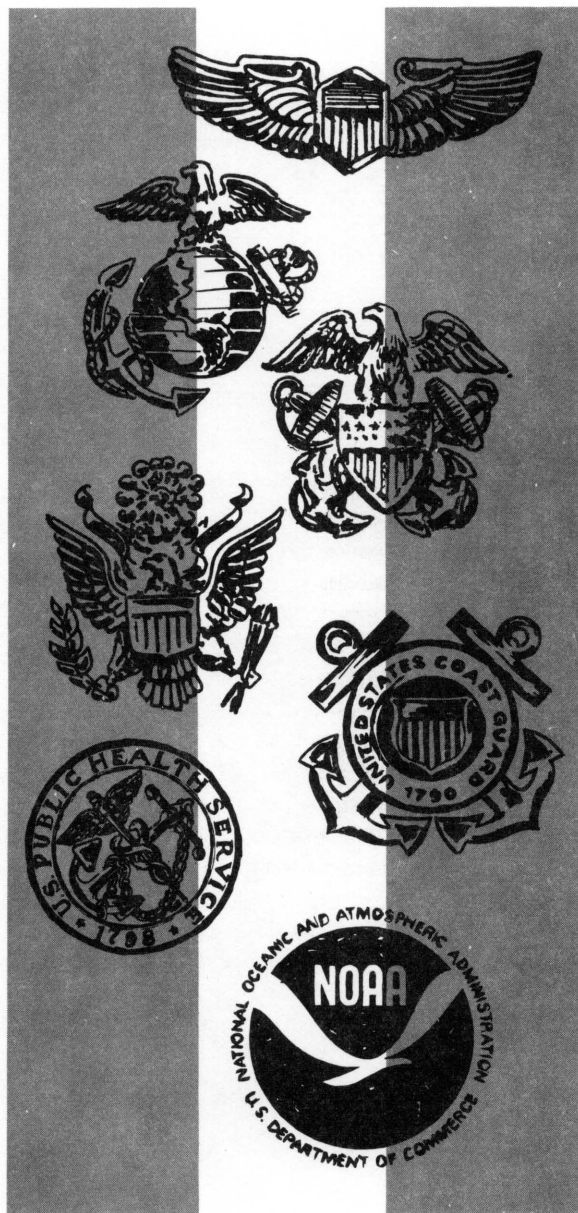
Harry E. Kinney, Albuquerque, New Mexico
Jack D. Maltester, San Leandro, California
John H. Poelker, St. Louis, Missouri
Vacancy

MEMBERS OF STATE LEGISLATIVE BODIES

John H. Briscoe, Speaker, Maryland House of Delegates
Robert P. Knowles, Senator, Wisconsin
Charles F. Kurfess, Minority Leader, Ohio House of Representatives

ELECTED COUNTY OFFICIALS

John H. Brewer, Kent County, Michigan
William E. Dunn, Commissioner, Salt Lake County, Utah
Conrad M. Fowler, Shelby County, Alabama



State Taxation of Military Income and Store Sales

**ADVISORY COMMISSION ON
INTERGOVERNMENTAL RELATIONS**

Washington, D.C. 20575 • July 1976

PREFACE

The Commission's statutory purposes include discussion at an early stage of emerging public problems that are likely to require intergovernmental cooperation and remedial legislative action. The application of state tax laws to military personnel and sales at military stores stands out as one such problem.

The exemption of military store sales from state sales and excise taxes and the poor compliance record of military personnel with state income tax requirements have become sources of increasing intergovernmental tension as state taxes rise and as the differences between military and civilian life styles diminish.

To allow the parties at interest in this controversial public policy area an opportunity to express their views, the Commission invited representatives from the uniformed services—both active and retired—the Department of Defense, and state tax officials to testify at a special hearing on September 11, 1975. Their prepared statements are included as an appendix to this Commission report.

This report and its accompanying recommendations were adopted and approved for publication by the Commission at its November 18, 1975, meeting.

Robert E. Merriam
Chairman

ACKNOWLEDGMENTS

John H. Bowman performed the research and wrote the chapter on state taxation of military pay. Michael Veseth performed the research and wrote the chapter on state sales and excise taxation of military store sales. Frank Tippett estimated the revenue loss due to poor military compliance with state personal income tax laws. Will Myers and Carol Weissert had a hand in preparing the report for publication. Overall supervision of the preparation and publication came from John Shannon, assistant director, taxation and finance.

The Commission and the staff benefited from the help of many individuals and organizations but expresses special gratitude for the cooperation shown by Charles Conlon, Floyd Fox, Col. William A. McSpadden, Daniel Smith, and Thomas Stanners.

These individuals along with those who participated in the Commission's hearing in conjunction with this report assured a frank exchange of views on this public policy question. The Commission staff takes full responsibility, however, for the contents and the accuracy of the report.

Wayne F. Anderson
Executive Director

John Shannon
Assistant Director

CONTENTS

<i>Chapter I—Findings and Recommendations</i>	1
Introduction	1
Findings	2
Policy Recommendations	3
1. Extend State and Local Sales and Excise Taxes to Military Bases	3
2. End Domicile-Only Jurisdictional Rule Governing State and Local Taxation of Military Pay	4
3. Require Withholding of State and Local Income Taxes from Military Pay	4
4. Provide for Enforcement of Delinquent Tax Obligations of Federal Employees	4
5. Require Certification of Domicile	5
 <i>Chapter II—Sales and Excise Taxation of On-Base Sales to Military Personnel</i>	 7
Historical Perspective	7
Key Issues	10
 <i>Chapter III—State-Local Taxation of Military Pay</i>	 21
Statutory Background	21
Jurisdictional Restrictions	21
Administrative Restrictions	23
Changing Rationale	23
Key Issues	24
State Jurisdiction to Tax	24
Consequences of Restrictions	25
Consequences of Ending Restrictions	36
 <i>Appendixes</i>	 43

FINDINGS AND RECOMMENDATIONS

INTRODUCTION

In this report, the Advisory Commission on Intergovernmental Relations deals with two issues.

- Should the Congress remove the legal barriers to state and local taxation of sales made in military post exchanges and commissaries?
- Should Federal policymakers overhaul their present statutes so as to improve military compliance with state and local income tax law?

Concern about these two issues stems partly from the fact that the military lifestyle is becoming more civilian in character — a trend that weakens one of the most persuasive arguments for shielding the military from the full impact of state and local income and sales taxes. The tendency for the military to look more like their civilian counterparts is underscored by several recent developments.

- Military service now is on a volunteer basis rather than by conscription.
- Military pay scales have increased dramatically, and recent studies indicate

that parity with civilian pay has been achieved for all but the bottom few military ranks.

- All but a small percentage of married military personnel have their families with them at their duty stations so that separation is now the exception rather than the rule.
- There is an increasing tendency for military personnel to live off-base in private housing, and more than two-thirds of married military men already do so.
- Military service generally no longer means isolation from civilian communities and private sector shopping facilities.

This concern about state and local taxation of military pay and PX purchases can also be traced to certain fiscal facts of life. The spread and growth of state and local income and sales taxes over the last two decades has transformed the preferential tax treatment of the military from a matter of small fiscal consequence to an economic fringe benefit of substantial value. As recently as 1954, only 34 states had a general sales tax. The median tax rate then was only 2 percent, and the highest rate was 3 percent. By 1973, 46 states collected a general sales tax; the median rate was 4 percent, and the maximum state sales tax rate had climbed to 7 percent. During this same period the number of states with an income tax had risen from 30 to 40. Based on our estimates, the average civilian family's state and local income and sales tax payments have risen from about \$120 in 1954 to approximately \$450 in 1974. (Comparison in 1974 dollars).

These significant changes stand out as the primary reasons for this reevaluation of the military tax issue. The balance of this chapter summarizes the major findings of this report and sets forth the commission's policy recommendations.

FINDINGS

The wide variety of consequences resulting from the current tax treatment of the military falls into five major intergovernmental areas: revenue generation, tax equity, tax administration, tax compliance, and economic behavior.

Revenue Generation — The preferential state-local tax treatment of military personnel, mandated by Federal law, now costs state and local governments about a half a billion dollars every year. ACIR estimates that state and local governments lose nearly \$400 million through exemptions on sales, tobacco, and alcohol, *i.e.*, beverage taxes and about \$100 million in personal income taxes. In the aggregate, the losses are not large relative to total state-local revenues, because the military population is not large — military members account for about 2 percent of the nation's labor force. But in some states and localities the losses (and therefore the inequities) are quite significant.

Equity — Under current Federal laws, tax equity suffers, whether considered in the horizontal or vertical context and whether measured against ability to pay or benefits received. Many military personnel who actually reside in a state and receive services there pay considerably less in taxes than they would if they were civilians. Sales and excise taxes are not collected from such persons to the extent that they shop in military exchanges and commissaries, and income taxes cannot be levied on the military pay of such residents if they are not also domiciled in the state. Areas which have non-domiciliary military personnel, then, must subsidize the consumption of public services by these persons through either higher taxes or lower services, or both.

Tax Administration — The ability of the states and their localities to administer their sales, excise, and income taxes is adversely affected by current Federal laws. Sales and excise tax administration is hindered largely by economic distortions (such as cigarette bootlegging), resulting from tax-free sales opportunities. Although there is little hard data to indicate how much bootlegging is currently taking place, ACIR computations indicate that there does seem to be a direct link between a state's cigarette tax rate and the volume of cigarette sales on military bases.

With regard to income taxes, administrative difficulties stem from two causes. First, the absence of withholding and lack of any effective information system mean the state-local tax officials have less information about military pay and its recipients than about other earned income and its recipients. As a result, application of state-local income taxes to military pay is more costly

to administer and less effective in compliance than it would be if military pay were subject to withholding. Second, the domicile-only rule makes possible tax avoidance through improper declaration of a domicile state, and the general lack of information on military personnel and pay makes detection of this fact quite difficult.

In all probability, these Federal obstacles to effective compliance have contributed to the decision of several states to fashion a liberal income tax exemption policy for the military.

Tax Compliance — Some major income tax compliance problems result from current Federal laws, and there is evidence that military compliance with state-local income taxes is generally low. Absence of withholding denies military pay recipients the convenience of pay-as-you-go state and local income tax payments that is available to recipients of other forms of earned income. As a result, such taxes must be paid in larger lump sums on a quarterly or annual basis. In addition, absence of withholding may (incorrectly) suggest absence of tax liability and result in tax delinquency and eventual penalties. The domicile-only jurisdictional rule likewise is a source of taxpayer confusion and difficulty. An inquiry to the local tax office may yield the information that no tax is owed in the state where the person is stationed, but information on tax liability (if any) in the domicile state will be more difficult to obtain. Also, because the domicile-only rule pertains solely to military pay and not to all pay of military personnel, it means different portions of income of many military families are subject to different rules.

Economic Behavior — Federally mandated preferential state-local taxation of military personnel affects economic decisions. In the case of sales and excise taxes, the availability of tax-free military stores provides an opportunity for the military member (and other eligible persons, such as military dependents and retirees) to avoid state and local excise taxes by shopping on base rather than in the private economy, and the incentive to do so is enhanced by the generally lower before-tax prices on base. In addition to the legitimate use of such on-base stores, there is an incentive to be a “good neighbor” by buying on base for friends and neighbors not entitled to shop the commissaries and exchanges, or even to turn a profit by reselling items purchased on base

at a higher price. The tax-exempt status of military store sales provides at least part of the incentive for such activities, and it may be governing in cases — such as cigarettes — where the state-local tax constitutes a sizable fraction of the total off-base price.

The income tax-related incentives created by the Federal laws concern domicile selection. ACIR figures suggest strongly that many military personnel — particularly higher paid personnel — perceive the tax advantages available under current state income tax laws as they apply to the military and select their domicile accordingly.

POLICY RECOMMENDATIONS

This section presents the policy recommendations adopted by the Advisory Commission on Intergovernmental Relations upon consideration of the information summarized in this chapter and presented in detail in the balance of this report. The recommendations call for changes from current law in each of the basic issue areas identified in this report. The Commission believes that removing Federal obstacles to making state and local tax laws equally applicable to military and civilian personnel would improve our federal system of shared powers in general and the quality of state-local taxation in particular. The recommendations that follow would remove these Federal obstacles.

Recommendation 1

Extend State and Local Sales and Excise Taxes to Military Bases

The Commission concludes that the current exemption of on-base sales to military personnel from state and local taxation should be removed. The Commission therefore recommends that the Congress give early and favorable consideration to legislation amending the Buck Act to allow the application of state and local sales and excise (including tobacco and liquor) taxes to all military store sales in the United States.

Changes in military lifestyle, higher military pay, the advent of the all-volunteer Armed Forces, increased state-local reliance on sales taxes, and the need to decrease cigarette bootlegging, to improve state-local tax equity, and to reduce

state-local revenue losses all contribute to the support of this recommendation.

In addition, there is little compelling reason why states and local governments should provide this "fringe" benefit to one class of Federal employees. The Federal government establishes the terms and conditions of military service, and yet state-local tax concessions seem to be used to make up for perceived disadvantages. Especially ironic is the fact that Federal excises, such as the cigarette tax, are imposed on military-base sales. In addition, one may question the wisdom and equity of compensation which varies in amount according to such variables as consumption of taxed goods and closeness to exchanges and commissaries.

Recommendation 2

End Domicile-Only Jurisdictional Rule Governing State and Local Taxation of Military Pay

The Commission concludes that military active duty pay should be taxable under the same jurisdictional rule that applies to all other forms of compensation. The Commission therefore recommends that Section 547 of the Soldiers' and Sailors' Civil Relief Act (50 U.S.C., Appendix Sec. 574 (1970)) be amended to remove the stipulation that only the service member's state of domicile or legal residence can tax his active duty military pay. The Commission further recommends that a state having a domicile jurisdictional rule retain authority to tax the military pay of its domiciliaries, as it does with civilian compensation, but that such a state allow a credit against its tax for taxes paid on the same income to another state.

Primary reasons for supporting this recommendation are the current military lifestyle (no separation from families and an established pattern of living off base), the fact that few military personnel are stationed in their domicile state, and the need to provide for more uniform application of tax laws to establish equity between civilian and military personnel and among military personnel within a state. Also, the change proposed in this recommendation would close a loophole that readily permits tax avoidance, and it would facilitate tax administration and tax compliance.

Recommendation 3

Require Withholding of State and Local Income Taxes from Military Pay

The Commission concludes that the OMB Circular A-38 information program was, and that a revival of that type program would continue to be, an inadequate response to the income tax requirements of both military personnel and state and local tax administrators. The Commission therefore recommends that Congress amend P.L. 82-587 (governing state income taxes), the District of Columbia Revenue Act of 1956 (governing the D.C. income tax), and P.L. 93-340 (governing local income taxes to require withholding of state and local income taxes from military pay. In this latter instance, military and Federal civilian employees should be considered jointly in determining whether the threshold of 500 Federal employees that triggers local income tax withholding has been reached.

Withholding of state-local income taxes from earned income is now virtually universal with the exception of military pay. Extension of withholding to military pay would ease tax compliance problems for military personnel by making pay-as-you-go payments available to them, and it would remove much uncertainty that now exists concerning military liability for state-local income taxes. In addition, the level of compliance with state-local income taxes would be increased and the costs of tax administration would be reduced.

Recommendation 4

Provide for Enforcement of Delinquent Tax Obligations of Federal Employees

The Commission recommends that Congress adopt legislation waiving Federal immunity from state court actions to the extent necessary to allow wage garnishments of military pay and of Federal civilian pay for delinquent state or local income taxes. Such legislation should explicitly instruct the Federal agencies to accept and act upon court orders in such cases.

It is improper for Federal immunity from state court actions to shield individual Federal employees — civilian or military — who willfully ignore their legitimate state-local tax liabilities.

Moreover, intergovernmental comity requires this waiver of Federal immunity because wages of state-local employees already can be attached to satisfy Federal tax obligations. A recent law permitting garnishment of Federal wages in response to state court orders to secure payment of child support and alimony established the precedent for such limited waiver of Federal immunity.

Recommendation 5

Require Certification of Domicile

The Commission recommends that the Department of Defense require a separate form specifically designed to obtain from the military personnel a declaration of legal residence for tax purposes and also require that records of legal residence be kept current through annual updating.

poses and also require that records of legal residence be kept current through annual updating.

The majority of states with income taxes seek to impose these taxes on a domiciliary's income, whether the domiciliary (*i.e.*, legal resident) is present in the state or derives income in the state (credits and reciprocal agreements then protect against double taxation). Because of this, there is need for regular information as to legal residence. Withholding does not meet this need when actual residence and legal residence are different. The use of the W-4 form for this purpose under the former *OMB Circular A-38* demonstrated the need for a form designed specifically for obtaining declarations of legal residence. Complete lack of this information leaves gaps in tax administration and enforcement, and incorrect domicile information — as often occurred under A-38 — causes wasted administrative effort.

SALES AND EXCISE TAXATION OF ON-BASE SALES TO MILITARY PERSONNEL

HISTORICAL PERSPECTIVE

Throughout the early years of American history, military outposts were served by private enterprise traders, merchants, and camp followers who sought to provide men in uniform with non-issue merchandise at a profit. Unfortunately, some of these traders were less than scrupulous and their profits more than "reasonable." As a result, for many years, the Federal government has operated on-base stores which provide U.S. military personnel with convenient and inexpensive retail outlets. These exchanges, commissaries, and ship's stores were originally intended to service military outposts located far from civilian retail outlets. Yet, for a variety of reasons, military stores are now on most bases whether isolated or not. These stores provide a wide variety of goods and services to military personnel at a cost usually below that available off base.

Since post exchanges (PXs) and other on-base retail outlets are normally located in areas of exclusive Federal jurisdiction (where state and local tax laws do not automatically apply), sales on-base have long been shielded from state and local taxes. In 1940, Congress passed the *Buck Act* allowing state and local governments to tax certain transactions which occur in Federal areas, but the law specifically excludes state and local taxation of transactions at post exchanges, commissaries, and ship's stores.¹

Table 1
On-Base Sales to Military Personnel, FY 1973

States	Commissary and PX Sales	Tobacco ¹ Sales	Alcoholic Beverage Sales	Total Sales
U.S. Total	\$4,149,033,267	\$307,742,187	\$386,454,877	\$4,843,230,331
Alabama	86,241,254	6,664,837	9,981,013	102,887,104
Alaska	73,800,263	3,025,040	7,011,300	83,836,603
Arizona	74,634,935	2,072,773	5,490,131	82,197,839
Arkansas	27,520,558	2,018,773	2,552,402	32,091,733
California	751,974,997	60,970,306	68,047,238	880,992,541
Colorado	97,811,857	7,296,403	5,283,115	110,391,375
Connecticut	27,559,098	2,225,011	3,533,514	33,317,623
Delaware	13,388,097	1,137,968	1,009,937	15,536,002
D.C.	87,570,501	8,000,000 ²	7,483,912	103,054,413
Florida	274,012,407	21,838,575	25,532,406	321,383,388
Georgia	155,468,848	12,206,901	11,077,112	178,752,861
Hawaii	164,110,333	6,723,718	19,033,652	189,867,703
Idaho	8,824,044	674,094	749,536	10,247,674
Illinois	91,567,303	7,380,483	7,975,085	106,922,871
Indiana	20,582,732	1,550,519	3,748,425	25,881,676
Iowa	—	—	—	—
Kansas	48,278,844	3,761,084	4,888,542	56,928,470
Kentucky	64,770,359	5,229,715	4,747,425	74,747,499
Louisiana	71,435,647	5,714,485	4,212,800	81,362,932
Maine	20,824,336	1,625,677	2,673,318	25,123,331
Maryland	88,346,203	6,251,918	8,130,800	102,728,921
Massachusetts	74,017,022	5,833,970	10,389,942	90,240,934
Michigan	33,395,472	2,565,617	2,903,806	38,864,895
Minnesota	5,798,149	422,889	1,119,514	7,340,552
Mississippi	51,618,467	4,143,362	4,704,568	60,466,397
Missouri	46,397,464	3,678,486	3,618,288	53,694,238
Montana	11,630,897	892,759	918,041	13,441,697

If one soldier sells his car to another on a military base, state sales taxes can be levied on the sale. However, the law does not apply to the sale, purchase, storage, or use of properties sold to "authorized purchasers" by the United States or any of its instrumentalities (e.g., military stores). An "authorized purchaser" is a person who is permitted to make purchases from commissaries, ship's stores, and post exchanges.

In other words, the legal status of military reservations and the provisions of the *Buck Act* effectively bar state and local taxation of on-base sales to active duty military personnel, retired military personnel, active duty reservists, the dependents of the above, plus certain other groups including military widows, 100 percent

disabled veterans, and members of the Public Health Service and the National Oceanic and Atmospheric Administration.

The dollar value of the military stores' transactions is significant, over \$4.8 billion in Fiscal Year 1973, and \$5.6 billion in Fiscal Year 1974. *Table 1* shows the volume of sales on military bases by state for Fiscal Year 1973.

The Rationale for Abolishing Preferential Taxation

In the beginning, commissaries and PXs were built solely for the use of those military persons stationed far from civilian retail outlets. As a

Table 1 (Cont.)

On-Base Sales to Military Personnel, FY 1973

States	Commissary and PX Sales	Tobacco ¹ Sales	Alcoholic Beverage Sales	Total Sales
Nebraska	29,689,804	2,216,393	2,335,226	34,241,423
Nevada	21,485,843	1,671,254	1,509,673	24,666,770
New Hampshire	16,575,987	1,237,429	1,598,229	19,411,645
New Jersey	90,914,036	7,456,827	6,282,088	104,652,951
New Mexico	43,448,578	3,268,877	3,773,333	50,490,788
New York	89,888,069	7,075,221	10,280,159	107,243,449
North Carolina	145,328,168	11,892,901	12,097,052	169,318,121
North Dakota	21,403,221	1,683,091	2,690,254	25,776,566
Ohio	43,946,211	3,260,554	5,910,746	53,117,511
Oklahoma	64,005,735	4,877,454	5,500,969	74,384,158
Oregon	2,283,427	151,289	112,707	2,547,423
Pennsylvania	46,888,302	3,627,076	10,528,876	61,044,254
Rhode Island	40,625,546	3,328,873	6,284,617	50,239,036
South Carolina	122,709,722	9,993,533	11,491,156	144,194,411
South Dakota	11,261,406	866,699	2,411,524	14,539,629
Tennessee	29,994,867	2,494,201	3,200,681	35,689,749
Texas	359,988,538	28,229,988	25,162,289	413,380,815
Utah	17,376,014	1,316,258	2,169,607	20,861,879
Vermont	339,803	20,388	14,452	374,643
Virginia	339,081,777	18,282,958	32,825,804	390,190,539
Washington	126,720,035	9,790,627	12,445,213	148,955,875
West Virginia	—	—	—	—
Wisconsin	5,056,247	472,054	245,454	5,773,755
Wyoming	8,441,844	622,879	768,946	9,833,669

¹Includes all tobacco items.

²Estimates.

Source: *Military Market Facts Book*, 1974.

chairman of a subcommittee of the House Armed Services Committee said in 1949.

The whole theory of the commissary privilege . . . was originally to give it to the people who were at isolated stations who did not have the benefit of metropolitan sales. That is the whole theory and the only justification for it. It was never intended that the government would be in the business of providing for its personnel where they have the privilege and opportunity to go to a private place to buy. It was intended on account of the remoteness of stations to accommodate them.²

In Fiscal Year 1973, there were a total of 267 commissaries and 476 PXs located on the 430 military installations in the continental United States. Many of these installations are in or near metropolitan areas and cannot qualify as "isolated stations." A General Accounting Office study involving a survey of cities revealed 27 commissaries operating on bases virtually surrounded by retail food stores.³

When military store operations were first begun, most military persons lived on-base, so the commissary and PX stores were roughly equivalent to the neighborhood general store. Now, however, over two-thirds of married military personnel, and a sizable portion of single military people, live off base. These people often have to

make special trips to shop at the base military store. The military store for these people is no longer a "neighborhood" convenience; it is the equivalent of a supermarket in many instances.

The military life style has been substantially altered by an increase in military pay designed to produce an all volunteer force. As a result, military persons are no less able to bear the burden of state and local taxes than are citizens in general. As recently as 1963, a military recruit earned only \$78 per month basic pay. This pay rate has now increased to over \$340 per month. Other, higher paid, military ranks have experienced pay increases ranging from 76 to 351 percent since 1963.

The current level of military compensation relative to civilian compensation is, of course, more important than the rate of increase. This comparison also is favorable to the military. Estimates show regular military compensation to be in excess of civilian compensation from the third year of service for officers with the differential growing larger, in favor of the military, from that point. The comparison for regular military compensation of enlisted personnel is not as favorable, however, but based on the broader measure of "total military pay" is estimated to be in excess of civilian personnel in virtually every instance. (*Appendix A* gives comparative statistics on military and civilian compensation.)

Table 2 shows military basic pay rates by rank, together with non-taxable cash allowances, after the October 1974 pay increase. For comparison, 1963 (pre-Vietnam) basic pay by rank also is shown. The percentage increases in basic pay over the decade range from 100 percent or less for generals who bumped against the statutory pay ceiling to as much as 350 percent for recruits and privates. Note, however, that because of the non-taxable cash allowances the pay ceiling for military has been more than 10 percent above the \$37,800 level applicable to Federal civilian employees. It is also worth noting that even the military recruit now is paid at a level above the minimum wage.

State tax systems have been changing. As recently as 1954, only 34 states had general sales taxes. The median rate was only 2 percent and the highest rate was a modest 3 percent. Currently, 45 states collect a general sales tax. The median rate has jumped to 4 percent, and the maximum rate to 7 percent. All 50 states plus the District of Columbia currently impose excise taxes

on cigarettes and alcoholic beverages at steadily rising tax rates.

Thus, as the U.S. government has grown from a provisioner in isolated outposts to a major operator of retail outlets, the exemption of on-base sales from state and local sales and excise taxation has been transformed from a fringe benefit of small fiscal consequence to a significant supplement to military pay.

KEY ISSUES

The intergovernmental issues arising out of changes in military and civilian life fall into four general categories.

- **Tax Equity.** Tax systems generally attempt to impose similar tax burdens on individuals in similar situations. The exempt status of sales at military stores, to an extent, frustrates this goal of tax equity. Since most military employees and their dependents live off base, they are, in many respects, comparable to their non-military neighbors. Yet, state and local sales and excise taxes can be avoided by the military family making on-base purchases, while the civilian family next door cannot legally avoid those taxes.
- **Revenue Loss.** The exemption of on-base sales from state and local sales and excise taxation has meant a direct, significant loss of revenue for these governments. The loss is compounded to the extent that lower PX prices have diverted retail business from off-base outlets (where state and local taxes apply) to non-taxable on-base stores.
- **Problems of Interaction with Local Economies.** The tax exemption of on-base sales, combined with the normally lower prices of military stores, draws business from the local private sector.
- **Bootlegging.** Because military stores often sell goods for less than regular outlets, some individuals have been involved in bootlegging of these goods for resale off base. This has been particularly troublesome with respect to tobacco

Table 2

Monthly Military Basic Pay, July 1963 and October 1974, and Monthly Non-Taxable Allowances and Total Annual Cash Pay and Allowances, October 1974, by Rank

Pay Grade	Rank	Years of Service ¹	Monthly Military Basic Pay			Monthly Non-Taxable Cash Allowances, 10/74 ²	Annual Total Pay and Cash Allowances, 10/74 ³
			July 1963	October 1974	Percent Increase 7/63-10/74		
E-1	Recruit	0-2	\$ 78.00	\$ 344.10	341%	\$116.40	\$ 5,526.00
E-2	Private	0-2	85.00	383.40	351	116.40	5,997.60
E-3	Private 1st Class	0-2	99.37	398.40	301	116.40	6,177.60
E-4	Corporal	2-3	150.00	437.40	192	133.80	6,854.40
E-5	Sergeant	4-6	205.00	513.00	150	154.80	8,013.60
E-6	Staff Sergeant	14-16	275.00	702.30	155	166.80	10,429.20
E-7	Sergeant 1st Class	18-20	340.00	825.60	143	178.80	12,052.80
E-8	Master Sergeant	20-22	370.00	948.30	156	190.20	13,662.00
E-9	Sergeant Major	22-26	440.00	1,138.80	159	202.80	16,099.20
W-1	Warrant Officer	10-12	334.00	798.30	139	220.32	12,223.44
W-2	Chief Warrant	16-18	393.00	969.60	147	234.32	14,822.64
W-3	Chief Warrant	20-22	470.00	1,150.80	145	252.72	16,842.24
W-4	Chief Warrant	26-30	575.00	1,458.00	154	269.82	20,733.84
O-1	2nd Lieutenant	0-2	222.30	634.20	185	199.92	10,009.44
O-2	1st Lieutenant	2-3	291.00	798.30	174	235.92	12,410.64
O-3	Captain	6-8	440.00	1,161.00	164	256.92	17,015.04
O-4	Major	14-16	570.00	1,470.00	158	277.92	20,975.04
O-5	Lt. Colonel	20-22	745.00	1,821.30	144	302.52	25,485.84
O-6	Colonel	26-30	985.00	2,310.60	135	322.52	31,605.84
O-7	Brigadier General	26-30	1,175.00	2,630.40	124	354.42	35,817.84
O-8	Major General	26-30	1,350.00	3,000.00 ³	122	354.42	40,253.04
O-9	Lt. General	26-30	1,500.00	3,000.00 ³	100	354.42	40,253.04
O-10	General	26-30	1,700.00	3,000.00 ³	76	354.42	40,253.04

¹ Longevity pay step of typical military member.

² Non-taxable quarters and subsistence allowances for officers; quarters; and clothing allowances for enlisted men (E-1 thru E-9) with dependents.

³ Statutory maximum.

SOURCES: *The Economics of Defense Spending: A Look at the Realities* (Washington: U.S. Department of Defense, Assistant Secretary of Defense [Comptroller], 1972), Table 15-1, p. 132; *1975 Uniformed Services Almanac* (Washington: Lee E. Sharff, 1975), pp. 9-15 and 23-26; and ACIR staff calculations.

co products. State and local cigarette taxes can amount to as much as \$2 per carton, enough to make the business of "bootlegging" attractive and to cause additional state and local revenue loss along with law enforcement headaches.

Tax Equity

The exemption of on-base sales to military persons from state and local sales and excise taxation raises serious questions when measured against tax equity standards of ability to pay and benefits received.

The notion of taxation according to ability to pay normally calls for people of similar means (similar incomes or wealth) to bear similar tax burdens. This is clearly not the case when one group of citizens (military personnel) can legally avoid payment of most state and local sales and excise taxes by purchasing items at on-base retail outlets. The tax burden on the military person is lighter than it would be on a civilian with comparable income or wealth by a factor directly proportionate to the amount of goods which he purchases through the commissary and PX system.

Similarly, the principle of taxation according to benefits received requires individuals who consume similar amounts of public services to bear similar tax burdens. This tenet is violated in the case of military persons who live off base, who consume roughly the same state and local public services as their neighbors, but who made a smaller contribution to the financing of these services because they are able to avoid the payment of sales and excise taxes through on-base purchasing.

Although the tax exemption privilege undercuts these tax equity criteria, certain additional factors must be taken into account before it is possible to make any final judgment on the tax equity issue. For example, it should be noted that most military persons pay at least some state and local taxes. They pay state-local taxes on all purchases made off the military reservations and on non-government purchases made on the bases (as called for in the provisions of the *Buck Act*), and those who reside off base probably pay real property taxes either directly or indirectly.

Second, it should be noted that military persons, especially those who live on the military

base, may not make use of state-local public services to the same extent as civilians. The notion of taxation according to benefits received would suggest that military families should bear a somewhat lighter burden than their civilian counterparts. The notion of taxation according to ability to pay, however, would dictate equal tax burdens.

Some spokesmen for the military contend that military persons are not comparable to civilians for taxation purposes. Military personnel have less control over their lives than do civilians. They may not "quit" their jobs when dissatisfied, but may terminate service only when their duty term has lapsed. Their jobs may involve loss of life or debilitating injury. These and other differences, it is noted, make the military person, the compensation he receives and the taxes he pays, difficult to compare to civilian workers. This argument is not directly applicable to certain groups which now share the tax-exempt military store privilege such as military retirees who live in the civilian community and generally have no further Armed Forces obligations.

The argument over the comparability of the military with the civilian life defies objective evaluation; on this question reasonable persons may disagree. On the application of the two principles of tax equity, however, there is no doubt that many military persons bear a lighter state and local tax burden than they should as a result of the exemption of military store sales from state and local sales and excise taxation.

Revenue Loss

The exempt status of on-base purchases by military personnel imposes a burden on state and local governments. The loss of revenue may be viewed as a tax subsidy to military people, mandated by the Federal government, but borne by states and localities.

The constitutionality of the present state-local tax exemption as it applies to Federally operated military stores is not under dispute. Yet, because the U.S. government does not choose to operate tax-free retail stores for the use of the general public, it must be assumed that the tax exemption as it applies here is intended to be an economic benefit accruing to Federal military personnel and related groups. Such an economic subsidy could be financed directly by the Federal government through higher levels of military compen-

sation. Instead, by making use of the constitutional prohibition against state or local taxation of a Federal entity, the national government has effectively passed on the cost of this benefit to state and local governments.⁴

The approximate size of this benefit is shown by *Table 3*, which gives the state sales and cigarette taxes which would have been paid on transactions in military store, had their sales been taxable in Fiscal Year 1973. These figures represent the cost of the tax-exempt status of military store sales to each state. The estimated total cost of the exemption from sales taxes is over \$135 million, and the tobacco tax exemption costs an additional \$130 million. Furthermore, states and localities suffer an estimated \$30 to \$40 million loss as a result of the exempt status of sales of alcoholic beverages. Liquor sales through military stores exceeded \$350 million in Fiscal Year 1973.

The size of the state-local subsidy — probably somewhat less than \$400 million — is about 1 percent of total state and local sales and excise tax collections. *Table 3* figures do not include the local tax loss or additional state and local sales taxes which would be paid on tobacco if tobacco taxes were imposed. But this comparison of aggregates belies the burden of the military tax subsidy in certain states and localities where military store sales are concentrated. For example: California's tax subsidy is estimated at more than \$49 million for the sales and tobacco excise taxes alone. Texas loses an estimated \$30 million; Florida, \$21 million; and Georgia, Virginia, and Washington, more than \$10 million each.

Problems of Interaction with Local Economies

Without question, the presence of a military base in an area is a stimulus to the local economy and is beneficial to local merchants. Nonetheless, the exempt status of purchases at military stores from state and local taxation, to the extent that it lowers already low military store prices, tends to disturb trade patterns. Business which might otherwise go to civilian merchants is drawn to the military outlets.

Military stores are a significant competitive factor for local merchants not only because of their number and location but also because of their volume. *Tables 4 and 5* compare sales by

the military store systems with sales of some of the largest U.S. retailers. The military commissary stores had \$2.1 billion in sales in 1974 and achieved ninth rank among U.S. food chains. The PX system had \$2.4 billion in sales to rank seventh among department store chains. The average sales of military stores is \$4.3 million. Some stores gross much more; for example, the store in Fort Myer, Virginia, takes in over \$15 million annually.

Military stores enjoy a natural advantage over civilian retail outlets because of their large size and lower prices. There is little doubt that retail sales to military personnel, retirees living in the community, and others are diverted from civilian to military retail outlets. To the extent that the exemption from state and local sales and excise taxes adds to the price advantage of military store purchases, local retail trade patterns are further disrupted.

Bootlegging

Military officials, state and local tax administrators, and others have shown continuing concern with the bootlegging of cheaper, tax-free military store items for resale off the military base. Attention has focused mainly on cigarettes. State and local cigarette taxes can amount to over \$2 per carton. The resulting price differential between cigarettes purchased tax-free in military stores and cigarettes purchased in regular retail outlets combined with the easy transportation of, and ready market for, cigarettes selling at a lower price, has apparently led to bootlegging activities among some military store patrons.

It would be unfair to characterize most military persons as "cigarette runners." Yet it appears that many military people have abused their special tax status by sharing their tax exemption with friends and relatives. Some military individuals have also used the price differential to earn extra money by illegally selling military store cigarettes at a profit.

The military is well aware of the potential for this bootlegging and has taken steps to inform military store patrons of the illegality of such actions. If caught bootlegging commissary or PX merchandise, a patron can lose his military store privilege or suffer more serious punishment. In addition, in order to make bootlegging of ciga-

Table 3

**Estimated Tax Losses Due to Exclusion of On-Base Sales From
State Sales and Excise Taxation, FY 1973**

States	Retail Sales Tax Loss¹ (in thousands)	Tobacco Tax Loss² (in thousands)	Combined Tobacco and Sales Tax Loss³ (in thousands)
U.S. Total	\$135,955	\$130,242	\$266,197
Alabama	3,450	3,949	7,399
Alaska	—	896	896
Arizona	2,238	768	3,006
Arkansas	826	1,363	2,189
California	26,507	22,583	49,090
Colorado	2,934	2,703	5,637
Connecticut	1,343	1,731	3,074
Delaware	—	590	590
District of Columbia	3,722	1,778	5,500
Florida	8,220	13,751	21,971
Georgia	4,664	5,425	10,089
Hawaii	6,564	1,993	8,557
Idaho	265	227	492
Illinois	3,663	3,281	6,944
Indiana	617	344	961
Iowa	—	—	—
Kansas	1,448	1,533	2,981
Kentucky	2,429	582	3,011
Louisiana	1,964	2,328	4,292
Maine	781	843	1,624
Maryland	2,650	1,389	4,039
Massachusetts	1,663	3,458	5,121
Michigan	1,336	1,045	2,381
Minnesota	174	282	456
Mississippi	2,581	1,688	4,269
Missouri	1,392	1,226	2,618
Montana	—	397	397
Nebraska	742	1,068	1,810

Table 3 (Cont.)

**Estimated Tax Losses Due to Exclusion of On-Base Sales From
State Sales and Excise Taxation, FY 1973**

States	Retail Sales Tax Loss¹ (in thousands)	Tobacco Tax Loss² (in thousands)	Combined Tobacco and Sales Tax Loss³ (in thousands)
Nevada	\$ 430	\$ 619	\$ 1,049
New Hampshire	—	504	504
New Jersey	3,409	5,248	8,657
New Mexico	1,738	1,453	3,191
New York	2,697	3,931	6,628
North Carolina	4,360	881	5,241
North Dakota	642	686	1,328
Ohio	1,318	1,811	3,129
Oklahoma	1,280	2,348	3,628
Oregon	—	50	50
Pennsylvania	2,110	2,418	4,528
Rhode Island	1,523	1,603	3,126
South Carolina	4,908	2,221	7,129
South Dakota	450	385	835
Tennessee	1,050	1,201	2,251
Texas	10,800	19,344	30,144
Utah	695	390	1,085
Vermont	8	9	17
Virginia	10,172	1,693	11,865
Washington	5,702	5,802	11,504
West Virginia	—	—	—
Wisconsin	152	280	432
Wyoming	338	184	522

¹State sales tax figures only — excludes local sales tax losses. In states where food is untaxed or taxed at a different rate, 25 percent of sales were assumed to fall into this category. Tax rates used are those applicable as of July 1, 1973.

²State tobacco taxes only — excludes local tobacco tax losses. Tax rates used are those applicable as of July 1, 1973.

³Does not include additional sales tax loss on higher tobacco prices if state tobacco taxes were imposed.

Source: ACIR staff computations: Table 1.

Table 4

**Sales Volume of Military Commissary System
Versus Top Nine Food Store Chains**

Rank	Store Chain	1974 Sales (in billions)
1	Safeway	\$8.2
2	A&P	7.0 ¹
3	Kroger	4.8
4	American Stores	2.8 ¹
5	Lucky	2.7
6	Jewel	2.6 ¹
7	Winn-Dixie	2.5
8	Food Fair	2.4
9	U.S. Military Commissaries	2.1
10	Grand Union	1.6 ¹

¹Estimated.

Source: *Progressive Grocer*, April 1975, and Department of Defense.

Table 5

**Sales Volume of Military Exchange System Versus
Top Seven Department Variety Store Chains**

Rank	Store Chain	1974 Sales (in billions)
1	Sears Roebuck	\$13.1
2	J. C. Penney	6.9
3	Kresge	5.5
4	F. W. Woolworth	4.1
5	Federated	3.5
6	Rapid American	2.8
7	U.S. Military Exchanges	2.4
8	W. T. Grant	1.8

Source: Standard and Poor's and Department of Defense.

rettes less likely, several base commanders have instituted daily, weekly, and/or monthly purchase limits (generally restricting cigarette sales to 15 cartons per month, although more stringent limitations have been imposed). In general, the military has shown a willingness to cooperate with state and local officials to halt bootlegging of cigarettes and other military store items (including liquor).

Despite these efforts, it appears that military store cigarette bootlegging — whether for profit or for a less selfish motive — is still a problem.

Because instances of bootlegging military store

purchases seldom involve large organized operations (more often the military person or retiree brings home an extra carton for a neighbor or friend), it is expensive and virtually impossible to enforce state laws with respect to these purchases. Therefore, there is little hard data to indicate the current extent of bootlegging. Comparisons of per capita purchases among military patron populations and civilian store patron populations, however, indicate the potential significance of the problem. *Table 6* provides this comparison.

In states with high cigarette taxes, sales to mil-

Table 6

Estimates of Per Capita Cigarette Sales Among Civilian and Military Store Patron Populations Age 18 and Over, FY 1973

State (Tax Rate)	Civilian Store Per Capita Sales (Packs)	Military Store Per Capita Sales (Packs)
California (10 cents)	184	258
Connecticut (21 cents)	163	193
Florida (17 cents)	188	236
New Jersey (19 cents)	178	248
New York (15 cents)	175	248
North Carolina (2 cents)	350	222
Texas (18.5 cents)	171	233
Virginia (2.5 cents)	227	218
Washington (16 cents)	144	247

Note: Military per capita sales computed using the following assumptions: 95 percent of military tobacco sales are assumed to be cigarette sales; cigarettes are assumed sold at an average price of 27 cents. The military store patron population aged 18 years and over is assumed to be made up of 100 percent of active duty military personnel and their wives and retired military personnel, plus 4 percent of the group classified as "other dependents" of active duty personnel, plus 50 percent of the group classified as dependents of retired personnel. This total was then increased by 3.6 percent to reflect purchasers not included in the above groups based on an AAFES survey of commissary patrons to arrive at the total patron population. Resident non-military population was used to compute civilian sales figures.

Source: Army Times Publishing Company, *Military Markets Fact Book, 1973*, ACIR staff estimates.

itary store patrons are significantly higher than sales to civilian store patrons. For example, in Washington state, with a 16 cent per pack cigarette tax, cigarette sales among civilian store patrons 18 years and over averaged 144 packages per person in Fiscal Year 1973, but military store sales averaged 247 packages per patron per year. Likewise, in Texas (with an 18.5 cent cigarette tax), estimates indicate civilian sales of 171 packs per capita while military sales averaged 233 packs per patron. The corresponding numbers for Connecticut (21 cent tax) are 163 packs per civilian and 193 packs per military store patron.

Higher cigarette sales per patron at military stores tend to correlate directly with states imposing high cigarette taxes. Virginia with its 2.5 cent state cigarette tax — low compared to other states — showed a higher per capita sale at civilian stores than at military stores. Low cigarette taxes diminish the incentive to purchase tax-free cigarettes, or limit their marketability. In North Carolina, where the cigarette tax is 2 cents per pack (lowest in the U.S.), civilian purchases per capita are estimated to be over 50 percent greater than per patron sales at military stores. The Virginia and North Carolina experiences may have two explanations; (1) low cigarette taxes diminish the incentive to purchase cigarettes tax-free in military stores, and (2) civilians purchase taxable cigarettes in these states to bootleg into the Northeastern states where cigarette taxes are \$1.50 or more per carton higher than in Virginia and North Carolina.

The Department of Defense provided the Commission with figures to show that military store per capita cigarette sales average only 40 percent of civilian per capita sales. The estimates

use as their population base all persons eligible to shop at military stores, whether they do so or not.⁵ A more relevant figure, in the Commission's judgment, is per capita consumption on the basis of the population which actually benefits from store sales. The Department of Defense figures cover sales in military exchanges only. The Commission notes that both exchanges and commissaries make tax-free sales of cigarettes and that exchange sales are likely to be the relatively smaller part of tax-free cigarette sales because cigarette prices at the exchanges normally are higher than cigarette prices at the commissaries. In view of these considerations, it seems likely that cigarette sales per exchange patron, as defined in the Defense Department estimates, would be less than cigarette sales per capita for the entire civilian population. Thus, it is not clear that the Defense Department study contradicts the ACIR sales estimates. If *all* military store cigarette sales were included, the Department of Defense calculations, even using the higher population or customer base, might well indicate higher military purchases than civilian purchases per capita.

The higher per capita sales figures for military store patrons presented in *Table 6* suggest either that military people consume more cigarettes, on the average, than do civilians (and this mainly in high-tax states), or that some military persons are buying tax-free cigarettes for the consumption of persons other than themselves and their dependents. In the absence of any reasons to assume that the military are heavier smokers than civilians or that high taxes promote heavy smoking, it is reasonable to conclude that cigarette bootlegging is a significant problem in some states.

FOOTNOTES

¹4 U.S.C. 105-110 (1970).

²Quoted in the General Accounting Office's report to the Congress entitled, *The Military Commissary Store: Its Justification and Role in Today's Military Environment* (GAO: May 21, 1975) p. 1.

³*Ibid*, Page 7.

⁴Although state and local governments may not, of their own volition, tax Federal entities or impose taxes in areas of exclusive Federal jurisdiction, the Federal government may extend the right to them. This has already been done with respect to sales and excise taxation within national parks,

state taxation of gasoline on military reservations and under the provisions of the *Buck Act*, state taxation of non-government sales on military bases.

⁵The Department of Defense has disputed the ACIR staff estimates of per capita cigarette sales at military stores. In a letter to the Commission, a Defense Department representative wrote:

The Army and Air Force Exchange Service (AAFES), the largest of the three exchange systems, examined per capita consumption of cigarettes among their patrons. The publication, *The Tax Burden on Tobacco . . .* indicates that in Fiscal Year 1974 the national consumption of cigarettes averaged 141.7 packages per person. Records of AAFES reveal that during the most recent fiscal

year (FY 1975) approximately 29,862,000 cartons of cigarettes were sold in exchanges under AAFES in the continental United States. Records also indicate AAFES has 5,236,700 authorized customers, which can be equated to 57 packages per year per customer, far below the national average of 141.7 packages per person.

This estimate of per capita sales would indicate that either military persons consume fewer cigarettes than their non-military counterparts or they buy most of their cigarettes in non-military stores. In either case, the net flow of cigarettes would be into military bases, not out of them as suggested by the ACIR staff estimates.

Either implication is erroneous, however, because the two

sets of numbers are not comparable. The Defense Department estimate uses the concept of "authorized customers" in calculating per capita sales. This is not a relevant base to use in figuring per capita sales since it yields no information concerning the per capita sales to the more limited number of family groups who actually patronize military stores.

The ACIR staff estimates presented in *Table 6* attempt to compare cigarette purchases per person in actual patron populations, to the extent that these populations may be estimated. Additionally, the figures are computed for civilians and military base patrons 18 years of age or older. It is the opinion of the Commission that these figures represent, as accurately as available data permits, the true per capita sales pattern as between military and civilian outlets.

STATE-LOCAL TAXATION OF MILITARY PAY

STATUTORY BACKGROUND

Provisions in four Federal laws prohibit state taxation of military pay.¹ The *Soldiers' and Sailors' Civil Relief Act of 1940* provides that military duty pay can be taxed only by the state in which the Armed Forces member is domiciled, or is a legal resident.² Three different acts which extend withholding of state and local income taxes to Federal civilian employees prohibit withholding of these taxes from military compensation.³ In addition, Federal immunity from state court actions has meant that state and local governments cannot attach the wages of Federal employees — civilian or military — to satisfy delinquent tax obligations.

These provisions result in a state-local tax treatment of military pay that is different from the tax treatment of civilian income — and different, even, from the state-local tax rules that apply to non-military income of military personnel and their families. This differential tax treatment of military and non-military income of military personnel stems from Federal jurisdictional and administrative restrictions on the states.

JURISDICTIONAL RESTRICTIONS

State income taxes commonly apply to all income (regardless of where derived) of a “resident,” as well as to income of a non-resident

derived from sources within that state. Although the definition of a resident differs among the states, it encompasses one or more of the following:

- persons domiciled in the state;
- persons actually present within the state, either for a specified length of time or for other than temporary purposes; and
- persons who maintain a permanent place of abode within the state.⁴

Thus, a state's concept of residence for tax purposes may include those domiciled in the state, whether or not they are physically present.

When a distinction is drawn between domicile and residence, as in the *Soldiers' and Sailors' Civil Relief Act*, it generally is on the basis of intention and permanence of one's attachment to an area;

Residence means living in a particular locality, but domicile means living in that locality with intent to make it a fixed and permanent home. Residence simply requires bodily presence as an inhabitant in a given place, while domicile requires bodily presence in that place and also an intention to make it one's domicile.⁵

Once domicile has been established, physical presence is not necessary to maintain that domicile. Thus, a person can be domiciled in one jurisdiction and simultaneously be a resident of another:

In addition to its being a permanent home, domicile involves an element of intention, that is, it is a place to which, during an absence, one has the intention of returning and from which he has no present intention of moving. . . . (D)omile is said to be inclusive of residence, having a broader and more comprehensive meaning than residence. Residence, together with the requisite intent, is necessary to acquire domicile but actual residence is not necessary to preserve a domicile after it is once acquired. Conse-

quently, one may be a resident of one jurisdiction while having a domicile in another. And while every person has one and only one domicile a person may have no place which can be called his residence or he may have several such places.⁶

The *Soldiers' and Sailors' Civil Relief Act* precludes state taxation of military pay by a state in which the recipient is not domiciled:

For the purposes of taxation in respect of the personal property, income, or gross income of any (member of the Armed Forces) by any state, territory, possession, or political subdivision of any of the foregoing, or the District of Columbia, of which such a person is not a resident or in which he is not domiciled, compensation for military or naval service shall not be deemed income for services performed within, or from sources within, such state, territory, possession, political subdivision, or district, . . .⁷

This provision is understood to preclude state income taxation of military pay by any state other than the recipient's domicile state; the term "resident" appears to mean "legal resident" and to be synonymous with domicile. The Office of the Judge Advocate General of the Air Force, for example, has written that "the (*Soldiers' and Sailors' Civil Relief*) Act provides, substantially, that a member of the Armed Forces who is legally resident in one state but is living in another solely by reason of military orders, is not liable to the second state for income taxes with respect to service pay."⁸

To so construe the meaning of the word "resident" is not without precedent:

A distinction between "legal residence" and "actual residence" has been recognized; "actual residence" has connotations of a more temporary character, while the phrase "legal residence" is sometimes used as the equivalent of "domicile."⁹

Because some state income taxes apply to "legal residents" or "domiciliaries" even when they are not "actual residents," there exists the

possibility that a person who lives the entire tax year in a single state still may have a state income tax liability to a different state (his state of domicile)—even if all his income was derived in the state in which he actually resided. This situation, together with the different definitions of residence used in the several states and the importance of intent in the determination of domicile, creates certain complexities in the area of state income taxation — both for taxpayers and for tax administrators.

The section of the *Soldiers' and Sailors' Civil Relief Act* relating to state income taxation attempts to relieve Armed Forces members from concern for these complexities and from the threat of double taxation with respect to their military pay. The statute effectively precludes taxation of military pay by the state in which the military member is physically present if his domicile is in another state. But the non-military pay of military members is subject to tax in the state where it is earned, as is the case with earnings of civilians.

ADMINISTRATIVE RESTRICTIONS

In 1952, Congress authorized state income taxes to be withheld from the pay of Federal civilian employees, and later legislation extended withholding from these employees to local income taxes.¹⁰ Each of these acts prohibits withholding from military pay. The issue of withholding from military pay was addressed only in the legislative history of the 1952 statute and administrative difficulties were cited as the reason for the ban.¹¹ Subsequent acts picked up this feature without regard either to subsequent developments in military payroll processing or to the enactment of the withholding requirement by virtually all states and localities with income taxes.

In prohibiting withholding from military pay, Congress has imposed greater compliance burdens on individual members of the Armed Forces. Quarterly or annual payments must be made at the initiative of the military person. Absence of withholding also results in both uncertainty on the part of the military regarding their state or local obligations and non-compliance with the tax laws.

The lack of awareness of income tax obligation by the military is illustrated by the comment

of an enlisted person from Kentucky (a state in which military pay is fully taxable):

I've never paid because they've never notified me. I guess if I owe something they'll let me know. No one has ever told me anything about taxes since I've been in the service. If I have to pay, I would want them to take it out like with other taxes.¹²

Absence of withholding imposes additional administrative costs on state and local agencies. If reasonable compliance is to be attained, states must identify and locate those liable for a given tax, then contact them and follow up as necessary to obtain the tax due. Withholding shortcuts this process. If a state tax administrator succeeds in identifying a military person and establishes a tax liability there is no assurance that the tax will be collected. State-local officials are unable to attach military pay — as they can other pay — to satisfy delinquent taxes. Federal immunity from state court actions prevents such actions.

CHANGING RATIONALE

Such elements as the change in military compensation and life style, and the wider spread and greater burden of state and local income taxation argue for the re-examination of provisions of the *Soldiers' and Sailors' Civil Relief Act* just as they argue for reconsideration of provisions of the *Buck Act*.

The basic motivation for the *Relief Act*, to ease the transition from civilian life to involuntary military service, has long since changed. The large increase in military compensation and the accompanying general achievement of parity with civilian pay was described in detail in *Chapter 2*. Military personnel are now in the Armed Forces by choice; military persons are rarely separated from their immediate families for long periods; and mobility is not the severe problem it once was.

State and local income taxes are more widespread and more heavily used today as compared to 1940 when the *Soldiers' and Sailors' Civil Relief Act* was enacted. The number of states using the personal income tax has increased from 30 to 40;¹³ and receipts from such taxes increased from 2.6 percent of state-local general revenue in 1942¹⁴ to 9.4 percent in 1974.¹⁵

KEY ISSUES

In the 1940s, when the *Relief Act* was adopted, military service typically involved separation from family. With the family "back home" while the serviceman was away, the domicile-only jurisdictional rule appeared to be a way to avoid *jeopardizing* financial benefits provided to the serviceman's family. The original rationale no longer squares with the facts. Based on the data for 1972, over 98 percent of married military men stationed in the United States¹⁶ are living with their wives. Counting all domestic forces (including those on ships in domestic waters), 96 percent of military families are living together. When all married military men are considered — regardless of where stationed — 84 percent are living with their wives.¹⁷ Not only do military families usually live together, but the majority — 70 percent of married military men — live off-base in private housing, further weakening the civilian-military distinction.¹⁸

STATE JURISDICTION TO TAX

Military families have the opportunity under the 1940 law to maintain their residence in a state other than where they are stationed. They may wish to do so for reasons such as licensing for some occupations, filing and processing of wills, and sending children to particular state colleges at in-state tuition rates. It is questionable whether such objectives warrant a Federal policy that strips states of the ability to tax military families who are stationed within their borders and are currently receiving services from them. The desire to benefit from locating in a particular place is not unique to the military but is shared by civilians who move among states. Payment of taxes to the state where a person resides does not, by itself, cause a person to lose his domicile elsewhere.

Mobility of the military is another factor to be considered in weighing the appropriateness of the domicile-only jurisdictional standard required by the 1940 law. Clearly, military personnel are more mobile than the civilian population as a whole. In 1964 (before escalation of the Vietnam war), 36 percent of married military men made an intercounty move compared with 6 percent of married civilians. During the height of the Vietnam war, the military mobility figure

rose to about 50 percent in some years, while the civilian figure remained below 7 percent.¹⁹

Military mobility may not be as intense as overall measures indicate. For one thing, the military population is younger than the civilian population as a whole, and younger persons tend to be more mobile. The aggregates conceal variations in mobility among various parts of both the civilian and military population. The average length of duty tour is a useful indicator of the military requirements of personnel mobility. Data on the average length of stateside duty tours by rank, supplied by the Army, show a range of two to three years.²⁰ Some civilian occupation groups move as frequently. Some construction workers follow the seasons as well as the activity in their trade. Business executives, in the earlier stages of their careers, may move every year or two.

Withholding of State Income Tax

The standard argument against withholding state-local income taxes from military pay is that the variations from state-to-state and year-to-year in these taxes would pose an unreasonable and perhaps impossible administrative burden on the Armed Forces. The Defense Department recently said it would cost \$6.3 million in initial or start-up costs to withhold state taxes. Thereafter, costs would run \$1.7 million annually.²¹

Automatic data processing techniques have made withholding quite manageable. Under current jurisdictional provisions whereby change of domicile is not a frequent occurrence, withholding from military personnel should prove workable. Variations in state and local tax codes would have to be followed and withholding changed accordingly, but this is not unlike the task performed by private companies (or by the military services for their civilian employees) operating in several states and localities.

With centralized payroll processing (which is to be universal among the services in a year or so), removal of the *Relief Act's* domicile-only jurisdictional rule would complicate the withholding process. Withholding procedures should be manageable, however, since a change of duty station already requires that records be changed, particularly the record indicating where the paycheck must be sent. A change in the program to withhold income taxes for a different state might easily be made at the same time. When Congress last considered withholding on military pay in

1952, centralized payrolling with data processing equipment was not in widespread use.

Garnishment on Federal Pay

State and local tax agencies cannot get an attachment of the wages of Federal military and civilian personnel to satisfy legitimate state and local tax obligations which have become delinquent. Currently, their recourse is persuasion. The heavy burden of state and local income taxes, the increased level of military pay, and the consequent added incentive for evasion of legal state and local income taxes all suggest that delinquency will become an increasingly important problem. For example, it has been estimated that in Wisconsin “. . . the average annual amount of income tax added to our delinquent accounts receivable for servicemen is \$450,000. Less than 40 percent of this amount is eventually collected.”²²

Garnishment of state-local employees' pay to satisfy delinquent Federal tax obligations is accepted practice. Moreover, a precedent was established recently for waiver of Federal immunity from state court orders in certain situations. P.L. 93-647 requires Federal agencies — military and civilian — to comply with state court orders to enforce alimony and child support awards by withholding such payments from the pay of Federal employees. A limited waiver of Federal immunity from state court orders in the case of delinquent state and local taxes would appear to be an equally valid exercise of intergovernmental comity.

CONSEQUENCES OF RESTRICTIONS

Equity, compliance and administrative costs, revenue loss, choice of tax source, and tax base erosion are all affected by the Federal restrictions on state-local taxation of military pay.

Equity Aspects

The *Soldiers' and Sailors' Civil Relief Act* impairs the taxing jurisdiction of states and localities with respect to military pay and thereby the equity of this form of taxation. Some persons who live and/or earn income in that state and who enjoy service benefits that may be supported by that state's personal income tax have income (military pay) that escapes taxation. Mem-

bers of the Armed Forces who happen to be stationed in their state of domicile will contribute income taxes toward funding state services while others will not. Non-comparable burdens are placed on persons earning comparable incomes.

If a state attempts to treat all military personnel within the state similarly by exempting all military pay from its income tax, a situation that treats civilians inequitably in relation to the military replaces a situation which treats some military personnel inequitably in relation to other military personnel. The taxes necessary to support a given level of services then must come from a still narrower segment of the population. Tax exclusions or exemptions for the military translate directly into higher taxes for the rest of the population and/or reduced public services for all. Moreover, exclusions or exemptions that depend on the source or type of income rather than on the amount are inconsistent with the basic rationale for income taxation.

Civilian and Non-Domiciliary Military. The following examples illustrate the types of inequity that occur at the present time. Consider Lt. Jones and Mr. Smith. Each has \$10,000 income (excluding Lt. Jones' tax-exempt cash allowances for housing and subsistence). Each has a wife and two children. Jones and Smith are neighbors. Indiana, the state in which they reside, has a personal income tax levied at a flat rate of 2 percent, after deducting personal exemptions of \$2,000 for taxpayer plus spouse and \$500 per dependent. Thus, both Lt. Jones and Mr. Smith have \$7,000 taxable income, on which the state income tax would be \$140. But Lt. Jones, domiciled in Texas (a non-income tax state), has only military pay and therefore no income taxable in Indiana. Thus, because of the *Soldiers' and Sailors' Civil Relief Act*, two similarly situated families living in the same city and enjoying the same public services pay quite different state taxes — the civilian pays the full tax while the military person domiciled in another state (Texas) pays no state income tax to his host state (Indiana). In the example given, because Texas levies no personal income tax, Lt. Jones owes no state tax.

Domiciliary and Non-Domiciliary Military. *Soldiers' and Sailors' Civil Relief Act* provisions also create inequitable tax situations between members of the Armed Forces. To illustrate this, the same Lt. Jones can be compared with Lt.

Gray — an Indiana domiciliary stationed in Indiana, who has the same salary, family size, and living conditions as Lt. Jones.

Lt. Gray has a \$100 Indiana state income tax liability (taxable income is reduced from \$7,000 to \$5,000 by Indiana's exclusion from taxation of the first \$2,000 of military pay), while Lt. Jones, domiciled in Texas, owes no state income tax to either Indiana or Texas. This comparison between military personnel has led some states to conclude that full military pay exemption is necessary to avoid discriminating against the "native sons" (but at the cost of increasing the discrimination against civilians relative to military).²³

Resident and Non-Resident Military Domiciliaries of an Income Tax State. In 25 states and the District of Columbia, the military pay of a person domiciled in the state is taxable under the state income tax even if the person is stationed outside the state. The same basic example demonstrates the inequity of this situation. Assume again two Indiana domiciliaries, both lieutenants, both having \$10,000 basic military pay, both married, and both having two children. Lt. Gray is stationed in Indiana, as in the previous example, and Lt. Pierce is stationed in Washington state. Each man owes the \$100 income tax bill calculated above, but only Lt. Gray is in Indiana to consume the services funded by his tax payment. Lt. Pierce is in Washington, a state with no income tax. He will be subject to most Washington taxes (except to the extent that he makes consumption purchases on base), even though he is domiciled in Indiana and must pay the Indiana income tax (on all but his personal and dependents exemptions and \$2,000 of his military income). Lt. Pierce's situation illustrates the fact that differential tax treatment of military pay is not always preferential treatment.

Military and Civilian Domiciliaries of a Non-Income Tax State Living in an Income Tax State. Civilians typically are subject to tax where they are living and/or working, regardless of where they claim legal residence or domicile.

Consider Col. Maxwell and Dr. Arthur, two domiciliaries of Florida currently living in Virginia. Dr. Arthur is a college professor on a year's leave employed by a Federal government agency. Col. Maxwell's basic pay (excluding tax-exempt allowances) is \$25,000, the same amount that Dr. Arthur is receiving. The effective rate of

the Virginia income tax for a \$25,000 adjusted gross income is 3.3 percent or \$825. Because Dr. Arthur is a civilian employee, Virginia can and does impose its tax on his income. Because Col. Maxwell is in the military and domiciled outside Virginia, Virginia cannot impose its tax on his military pay. Yet, both live in the same Washington suburb, have the same income (ignoring military allowances), the same number of dependents, and enjoy the same state and local public services. Neither, of course, pays an income tax to Florida because this state does not impose the tax.

General Equity Consequences of Differential Taxation. An important equity implication of the tax treatment of military pay is that it operates to increase taxes and/or reduce the level of service for taxpayers in the host jurisdiction if personal income taxes are levied in that jurisdiction.²⁴ For example, Capt. Brown is domiciled in New York but is stationed in Maryland. He sends his two children to Maryland schools, uses Maryland parks and highways, and so on, but his military compensation is beyond the reach of Maryland's state and local income taxes. Other Maryland taxpayers must pay higher taxes (or consume less services) than they otherwise would if the pay of Capt. Brown and other military personnel stationed, but not domiciled, in Maryland were taxable in Maryland.

At the state level, the percentage of the population comprised of military personnel and their dependents typically (although not universally) is rather small — 2 percent or less.²⁵ For this reason, some may argue that there is no problem — that the lost taxes will not comprise a large share of total revenue. As a general rule this must be true, but the dollar amounts still may be significant.

Using Maryland as an example, total state personal income tax liability for all active duty military personnel living in Maryland is estimated at \$10 million.²⁶ If military pay could be taxed by the state where military personnel are physically present Maryland, however, would not benefit to the full extent of \$10 million.²⁷ Some military personnel in Maryland are domiciled there and presumably pay the state income tax for which they are liable. In addition, under a civilian (physical-presence) jurisdictional rule, Maryland would lose some tax revenue from Maryland domiciliaries stationed outside the state. Just what

the net revenue gain would be is not known, but in a state such as Maryland, with a relatively large concentration of military, it seems probable that the net gain would amount to half the gross military liability, that is, \$5 to \$6 million. This is about 1 percent of Maryland state income tax collections, but about 10 percent of the year-to-year increase in collections from this source.

Compliance and Administrative Costs

Federal restrictions on state-local taxation of military pay complicate compliance with tax laws and cause administrative headaches. The following are examples.

- Tax returns for military families with non-military income often are complicated by the application of different jurisdictional rules to the different sources of income.
- The domicile-only jurisdictional rule makes possible domicile selection on the basis of tax advantage and therefore provides the military with a means of tax avoidance and, at worst, of tax evasion that tax officials cannot easily detect.
- Because military domiciliaries of a state typically are located outside that state, compliance may suffer under the current domicile-only jurisdictional rule because of resentment of having to pay taxes to a state where services are not currently being received and because the distances involved complicate taxpayer identification, information, and auditing functions.
- Lack of withholding means that military personnel find the fulfillment of their state tax obligations more difficult because they are denied the convenience of making tax payments through regular payroll deductions — a convenience accorded almost universally, except for military pay. Absence of withholding means that taxes must be paid in much larger quarterly or annual lump sums through a payment process that must be initiated by the taxpayer.

- Uncertainty concerning tax liability is created by lack of withholding, and because no tax has been withheld there may be little incentive for the service member to inquire as to his responsibility.
- Tax officials are denied, by the lack of withholding, one of the most effective administrative tools and their task of identifying, locating, and collecting from those who should be paying income taxes is made more difficult.
- State-local tax officials' inability to garnish military pay to collect delinquent taxes leaves these officials with no legal recourse other than persuasion, which often is not enough.

Having highlighted the types of problems and their association with particular Federal restrictions, we now turn to more detailed consideration of some aspects of administrative and compliance consequences of the Federally mandated differential tax treatments.

The Compliance Problem. The confusion arising from current provisions enhances the chances of inadvertent non-compliance, but it also facilitates deliberate evasion (illegal) and avoidance (legal) by those inclined to shirk their state-local tax obligations. The easiest way to evade taxes is simply not to file even if the domicile state taxes military pay. This evasion may be identifiable, but only through very diligent and costly state tax administration and interstate cooperation among tax administrators.

The Armed Forces member may avoid paying state income taxes by selecting a domicile state on the basis of tax advantage. There are ten states that do not use the income tax and five income tax states that provide a full exemption for military pay. A serviceman may legally select one of these states as his domicile, provided the state's requirements for establishing domicile are met.

A civilian also may change his domicile, of course, but such a change does not have the same implications for the civilian's state income tax liability. Under the civilian (physical presence) jurisdictional rule, a civilian living or working in

an income tax state will be liable for that state's tax regardless of domicile.

If requirements for establishing domicile have not been met, a tax-influenced naming of a new domicile state by a military member is illegal tax evasion. Yet, it is difficult for state tax administrators to know whether domicile has been properly claimed (or not claimed), in part because intent is so important in determining domicile, and in part because current state tax administration practices applicable to the military make it possible for a military member to "fall between the cracks" in the absence of truly extraordinary efforts by state officials.

Until the Fall of 1975,²⁸ the Federal Office of Management and Budget required Federal agencies to report income payments not subject to withholding to the states and localities of residence. The requirement, embodied in *OMB Circular A-38*, was intended to help in the administration of the domicile-only jurisdictional rule. In practice the circular was of limited usefulness. Under this circular, every state should have received upon request W-2 type information for each military member domiciled in the state. If no legal residence was designated, the member's statement was sent to the state where he was serving. The circular stipulated that the forms used, while containing W-2 information, were not technically W-2s and were not to be identified as W-2s.²⁹

An example may illustrate the circular's shortcomings. Suppose Joe Smith is in the Army and claims to be domiciled in Florida. But Smith has not met the Florida domicile requirements, and actually is a domiciliary of Ohio and liable for Ohio income taxes. If Smith does not file an Ohio return, Ohio tax officials may never know he should file. If his Federal income tax return is filed from an Ohio address, this would provide a lead — but it may be filed from his current duty station in, say, Oklahoma. If a declaration of legal residence had been obtained under *OMB Circular A-38* procedure, it would show Florida as the domicile state in this case since the services are not required to verify the accuracy of a member's declaration of domicile. If such a declaration has not been obtained, Smith's wage statement would be sent to Oklahoma. In neither event would Ohio receive the wage statement.

Or suppose that for some reason Ohio tax officials obtain Joe Smith's name. Upon discover-

ing that they have no income tax return on file for him, they may contact him; Smith's probable response will be that he is domiciled in Florida. To verify the accuracy of this statement, Ohio must contact Florida officials, who would then have to check into the particulars of the Smith case to determine whether he is legally claiming domicile in Florida. Thus, interstate cooperation (involving agencies other than the tax departments) appears to be necessary. Florida, having no income tax payment at stake because it levies no such tax, may find the burden of checking unreasonable; but Ohio must, to some extent, depend upon Florida officials to assist Ohio's efforts to determine the tax status of Joe Smith. Such verification efforts, moreover, are quite costly and time consuming.

Current law further complicates state income tax compliance and administration for military families stationed outside the state of domicile and having non-military income, such as property income or earnings from a civilian job of either the military member or the spouse. Due to the varying jurisdictional rules, two states may be involved in the taxation of the military family's income. For example, a military couple domiciled in Ohio and stationed in Kentucky with non-military earnings in Kentucky will have to pay Ohio taxes on military pay and Kentucky taxes on the other income. The necessity of filing and paying taxes in two states is an obvious complication. In the example given, if military pay did not have special tax provisions, reciprocity arrangements between the states would protect against having to file in both states. Such reciprocity is rather common, at least in the Midwest and the East.

Joint filing arrangements also are made more complex by having different parts of a military family's income subject to the tax laws of different states. Most states require a joint return if a joint Federal return has been filed. In the case of a military couple having to file in two states with only part of the total income taxable in each, a complexity is introduced requiring special treatment (e.g., crediting or an exception to filing requirements) in recognition of the state tax status of military pay.

District of Columbia and Maryland Data. There is some fragmentary evidence of significant military non-compliance with state income taxes. The

tax agencies of the District of Columbia and the State of Maryland followed up on two groups of military personnel who did not file income tax returns with their respective offices: (a) those who filed Federal returns from a D.C. or Maryland address; (b) those for whom W-2s had been received under *OMB Circular A-38*.³⁰ In the first group, discrepancies between Federal and state filing do not necessarily indicate evasion of state taxes, so the mismatches must be checked out. For the second group, the W-2s *should* provide a good indication of where tax returns are to be filed — although experience has shown this is not always the case, and where it is not, administrative officials again are presented with problems.

The District and Maryland conducted a *Federal-state filing check* for tax year 1971. Using a sample of military personnel who responded to follow-up inquiry that legal residence in another state was the reason for not filing where the Federal return was filed (D.C. or Maryland), they obtained the following results.

	Number	Percent
Responses Followed Up	57	100
Filed in State Claimed as Legal Residence	15	26
Claimed Domicile in States with No Income Tax or with Full Exemption of Military Pay	23	40
No Return on File in State Claimed as Legal Residence	19	34

The first group (26%) clearly complied with existing tax laws. The second group (40%) may or may not have been in compliance depending on whether all those claiming domicile in a state imposing no tax on military pay were doing so legally. More detailed investigation would be required in these cases. The third group (34%) clearly failed to comply with existing laws. It should be noted, however, that the sample is small and not scientifically drawn, thus sweeping generalizations are not warranted.

The District and Maryland conducted another compliance check using 129 military personnel for whom W-2s were received from the Armed Forces under A-38. The results are given below.

	Number	Percent
W-2s Selected.	129	100
Filed with Jurisdiction Receiving W-2 (D.C. or Maryland)	39	30.2
Filed with Another State Claimed as Legal Residence	7	5.4
State Claimed as Legal Residence Has No Income Tax or Fully Exempts Military Pay	6	4.7
Filed with State Where Serving	10	7.8
No Return on Record in D.C. or Maryland, Where Such Return Appeared to be Required	67	51.9

The largest group filed no state income tax return. About one in three military persons for whom either the District or Maryland received W-2s filed tax returns with these jurisdictions. These results may not be representative of income tax compliance among military personnel in general.

Information from Minnesota for 1974 provides another type of evidence that military personnel may not be complying with their state tax obligations. Minnesota domiciliaries serving in the Armed Forces numbered about 38,300 in 1974.³¹ Yet, state tax officials reported receiving only 9,595 state income tax returns from Armed Forces members for 1974.³² In a speech to his fellow state tax administrators, W. A. Barnes of Mississippi estimated that the states, on average, still fall short of achieving a 50 percent level of compliance by military personnel with state income tax requirements.³³

Data from the Armed Services. To study whether military personnel systematically concentrate their claims of legal residence in states offering favorable tax treatment for military active duty pay, ACIR staff asked the Pentagon for state-by-state tabulations of the 1974 W-2 information supplied to the various states pursuant to *OMB Circular A-38*. The requested information consisted of three elements (a) the number of persons claiming legal residence for tax purposes, (b) the number of these stationed in the state in

which legal residence is claimed, and (c) the number claiming legal residence whose military compensation is at a rate less than \$10,000 annually. All of the Armed Services responded, although some were unable to supply all the information requested, particularly for the second and third items.

ACIR tabulated the information by six categories of state income tax treatment of active duty military pay in 1974. California, Oregon, and West Virginia could be classified in either of two categories but have been assigned to the single most logical one. The categories are as follows.

1. States having no broad-based personal income tax (ten states: Connecticut, Florida, Nevada, New Hampshire, New Jersey, South Dakota, Tennessee, Texas, Washington, and Wyoming).³⁴
2. Income tax states that fully exempt military active duty pay (five states: Alaska, Illinois, Iowa, Michigan, and Vermont).
3. Income tax states that exempt all military active duty pay attributable to service outside the state (three states: California, Idaho, and Pennsylvania).
4. Income tax states that do not tax domiciliaries outside the state if they meet three tests concerning place of abode and maximum time within the state (six states: Maine, Missouri, New York, Oregon, Rhode Island, and West Virginia).³⁵
5. Income tax states that offer partial exemptions for military active duty pay, wherever stationed (seven states: Arizona, Arkansas, Indiana, Minnesota, North Dakota, Oklahoma, and Wisconsin).
6. Income tax states that tax active duty military pay, wherever stationed (District of Columbia and 19 states: Alabama, Colorado, Delaware, Georgia, Hawaii, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Mississippi, Montana, Nebraska, New Mexico, North Carolina, Ohio, South Carolina, Utah, and Virginia).

Table 7 compares the percentage distributions of military claims of legal residence with the distributions of total population and of military accessions in a recent six-month period.³⁶

It seems reasonable to expect that accessions to the military would distribute among the states roughly in proportion with population. Any differences between accessions and population might be accounted for by such factors as different concentrations of service-age males, differences in other employment opportunities, differences in educational attainment, and the atypical character of the particular six-month period for which accessions data were readily available. In general, however, the population distribution can be regarded as a good measure of expected distribution of domicile or legal residence for military personnel, if legal residence claims are not affected by state tax considerations.

On the basis of data for all military personnel, there is only limited support for the hypothesis that military personnel can and do claim legal residence in part on the basis of state income tax advantage. The hypothesis has some support in *Table 7* from Air Force and Army figures for the non-tax states. These states have 19.0 percent of the population compared with 24.5 percent of Air Force personnel and an estimated 44.2 percent of Army personnel. Claims of legal residence by Marine Corps and Navy personnel are roughly proportional to population.

Because income tax considerations in selection of a legal residence might exert a stronger influence on higher-paid persons than on lower-paid persons, ACIR analyzed the data on legal residence of the military by those earning \$10,000 or less and those earning over \$10,000. The three columns in *Table 8* show relative concentrations of Air Force, Marine Corps, and Navy personnel receiving military compensation at an annual rate more than \$10,000 (comparable data were not received for the Army) in the six groups of states. The figures in the table are ratios relating the concentration of high-income military personnel in each group of states to the concentration of high-income military in the 50 states and D.C. Specifically, for each service and for each group of states, personnel receiving more than \$10,000 annual military pay were expressed as a percentage of all military personnel in that service and that group of states; comparable percentages were calculated for each service for the 50 states

and the District of Columbia as a whole. Within each service, the percentage for each group of states was taken as a ratio of the percentage for the U.S.

A ratio of 1.00 indicates a concentration of high-income military no different from that for the country as a whole, a ratio greater than 1.00 indicates a greater relative concentration of high-income personnel, and a ratio less than 1.00 indi-

cates a lesser concentration, relative to the country as a whole. If income tax considerations are exerting an influence in selection of legal residence, there would be a disproportionate concentration of personnel earning over \$10,000 in the no-tax states and a lower than average concentration of such persons in states offering no tax concession to military personnel.

The general pattern of the data in *Table 8*

Table 7

Comparison of Percentage Distributions of Population, Military Accessions, and Legal Residence for Tax Purposes of Military Active Duty Personnel Among States Categorized According to State Income Tax Treatment of Military Active Duty Pay

Category (and Number) of States for Tax Year 1974	Percentage of Population as of 4/1/73	Percentage of Accessions to Military Services January-June 1970	Percentage Distribution of Military Personnel Among States Claimed as Legal Residence for Tax Purposes for 1974, by Branch of Service			
			Air Force	Army	Marine Corps	Navy
States with No Broad-Based Personal Income Tax (10)	19.0%	16.9%	24.5%	44.26% ^a	19.4%	20.2%
Income Tax States, but with Full Exemption of Military Active Duty Pay (5)	11.4	13.2	8.7	6.5 ^b	10.4	9.6
Income Tax States but with Full Exemption of Military Active Duty Pay for Service Outside the State (3)	15.9	14.1	14.0	6.8	16.8	19.5
Income Tax States, but No Tax on Domiciliaries Who Meet Three Tests Concerning Place of Abode and Maximum Time in the State (6)	13.8	12.4	11.8	8.1 ^b	12.1	11.4
Income Tax States, but with Modest Partial Exemption of Military Active Duty Pay (7)	10.1	11.7	10.1	7.4	11.2	9.8
Income Tax States That Tax Military Active Duty Pay Wherever Stationed (19 and D.C.)	29.9	31.7	30.8	27.1	30.3	29.5

^aEstimated; see footnote 36.

^bEstimated in part; see footnote 36.

Source: See text.

supports the hypothesis that income tax considerations do make a difference in selection of domicile. The ratios for all three services were well above 1.0 for the no-tax states. Overall, 23 percent of military members are stationed in the ten non-income tax states.³⁷ But for the three services for which income-level data are available (Army excluded), 29 percent with income above \$10,000 claimed domicile in these states, versus 22 percent for all members of these three services.

In summary, available data suggest strongly (if not unequivocally) that many military personnel — particularly higher-paid personnel — perceive the tax advantages available under current state income tax laws as they apply to the military, and that significant numbers take advantage of the opportunity to avoid state income taxes through domicile selection.

Is there a benign explanation for the relatively high percentages of Air Force and Army personnel naming the ten non-income tax states as their legal residence states, or for the disproportionate concentrations of higher-paid Air Force, Marine Corps, and Navy personnel domiciled in these states? Military personnel do not simply name the states in which they are stationed as their legal residence states. Indeed, the general picture that emerges is that domicile or legal residence is a state other than the one in which the person is stationed in the overwhelming majority of cases. Marine data, for example, show that only 243 out of 6,837 members claiming domicile in Florida in 1974 were stationed in Florida in that year. This is not atypical. Yet, an unusually high correspondence between legal residence and duty station is that reported by the Navy for California. In 1974, two-thirds of those claiming domicile in California were stationed there.³⁸

Limitations of the Information Statement Approach. *Office of Management and Budget Circular A-38* was designed to aid state and local tax officials in the taxation of all Federal employees, civilian as well as military, except for those serving overseas. Although OMB rescinded A-38 in September 1975, citing conflicts with the new *Privacy Act*, the Department of Defense announced in November 1975 that it would continue to provide the same information that had been provided under A-38.³⁹ For this reason, the following discussion refers to A-38 provisions as if they still were in force. The A-38 designa-

tion provides convenient reference to the new Department of Defense procedures, which apparently will be similar if not unchanged from the military provisions of *OMB Circular A-38*. The A-38 experience is illustrative of the shortcomings of such an information process as a substitute for withholding.

OMB Circular A-38 requires the Armed Forces to obtain from each member a declaration of the legal residence, and to send a W-2 type statement to that state. The circular further provides, however, that the wage statement should be sent to the state in which the military member is serving if there is no current legal residence declaration on file.⁴⁰ The circular does not prescribe the form to be used for obtaining the declaration of legal residence, but the Department of Defense has settled upon use of the W-4 form (originally intended to show the number of exemptions claimed by a taxpayer) for this purpose.⁴¹

Aside from the *OMB Circular A-38* process, there are no Federal programs or provisions designed to help state and local tax officials cope with the administrative problems resulting from special military taxation. Moreover, the information supplied under A-38 often is of little value, or, at best, can be utilized only at a high cost to the taxing agencies. The principal problems with the circular are these:

- There is no assurance the procedures required by states to be legally claimed as domicile have been met.
- Many servicemen “slip through” the cracks and are not reported to domiciliary states they claim.
- Some of the wage statements received may be for non-domiciliaries.
- Many wage statements lack addresses or are impossible to read.
- Some services send wage statements in small quantities, from several sources, over a period of some weeks.

Discussions of the A-38 process with a few state tax administrators revealed discrepancies between the number of wage statements for active duty military actually received and the number reported to ACIR by the military services as hav-

Table 8

Distribution of Air Force, Marine Corps, and Navy Legal Residents With Annual Military Pay Above \$10,000 Among Groups of States Categorized According to State Income Tax Treatment of Military Active Duty Pay, 1974

Category (and Number) of States for Tax Year 1974	Military Personnel with Annual Duty Pay Above \$10,000 as a Percentage of All Military Personnel Claiming Legal Residence for Tax Purposes. Ratio, State Group Percent to 50-State Percent		
	Air Force	Marine Corps	Navy
States with No Broad-Based Personal Income Tax (10)	1.33	1.24	1.21
Income Tax States, but with Full Exemption of Military Active Duty Pay (5)	.99	.82	.88
Income Tax States, but with Full Exemption of Military Active Duty Pay for Service Outside the State (3)	.89	1.17	1.01
Income Tax States, but No Tax on Domiciliaries Who Meet Three Tests Concerning Place of Abode and Maximum Time in State (6)	.85	.95	.97
Income Tax States, but with Partial Exemption of Military Active Duty Pay (7)	.89	.71	.78
Income Tax States That Tax Military Active Duty Pay Wherever Stationed (19 and D.C.)	.89	.93	1.00

Source: See text.

ing been sent. In the summer of 1975, ACIR conducted a survey of the income tax states to determine the extent of the problem. The states were given the numbers of 1974 wage statements reported to ACIR by the services and were asked to verify the numbers.

In general, states had trouble identifying active duty military personnel from civilian employees of the services and from reservists. In some instances, the number of wage statements received exceeded the number reported to ACIR by the services — perhaps because the state tax agency had been unable to sort out just the active duty military personnel — but in several instances the number of wage statements received fell short of the number reported to ACIR.

For example, one state reported that the Air Force had supplied the state with a list of 6,165 persons (compare with 7,139 reported to ACIR by the Air Force) while no 1974 wage statements had been received from the other services. Another state reported receiving 21,107 wage statements rather than 25,692 reported to ACIR by the services. Comparing his figures with those supplied by ACIR, a Wisconsin tax official reported, "We have not received wage statements for all the active servicemen in any branch of the service."⁴² Wisconsin received only 1,536 of 7,580 Army wage statements reported to have been sent for 1974.⁴³

Because the wage statements often lack a current address for the military person, the states are frequently unable to make good use of the statements as a means of encouraging tax compliance. On the matter of providing a current, correct address, the performance of the services apparently differs widely if the Wisconsin experience is indicative. The Air Force included addresses with all the wage statements supplied to Wisconsin. The Marines included addresses with 98 percent of the statements supplied to Wisconsin. The Army and the Navy included addresses on only 55 percent and 13 percent respectively, of the statements sent to Wisconsin.⁴⁴ Several states had similar experiences and noted that the usefulness of a statement is very limited if there is no address. Moreover, an income tax official from one state reported that attempts to obtain addresses from the services subsequent to receipt of the wage statements — an added round of letters and a step that should be unnecessary — yielded only a series of illegible labels.

The second factor limiting the usefulness of the A-38 process stemmed from the dispatch of wage statements to the wrong state. When this happens, state tax officials end up pursuing false leads. The extent of this type of problem cannot be readily established, but its existence is confirmed by the results of the District of Columbia and Maryland survey reported earlier.

Some state tax officials commented that they were unable to obtain computer tapes of the W-2 information (in spite of the provision in A-38 that computer tapes can be specified by the states and localities). A few states received wage statements in many small bundles rather than in a few larger batches which made the use of the information cumbersome.

The *Circular A-38* process has the additional shortcoming of incomplete coverage. Information statements are provided only for personnel serving in the United States. Because state income taxes often apply even when a person domiciled in a state is outside that state, the coverage of A-38 is narrower than the coverage of many state income tax laws.

Revenue Loss

Incomplete tax compliance by military personnel stems currently from both inadvertence and deliberate evasion. The state revenue loss from both these sources is estimated at \$94 million. To obtain this estimate, the Commission staff took the following steps:

1. *Estimated taxable income of all military personnel* by using reported data on base pay, number of personnel, and number of dependents by pay grade. The taxable income estimated as a result of these calculations totalled \$17.5 billion for 1975.
2. *Estimated state tax liability of all military personnel as though all military pay was fully taxable in all states* by applying an average effective state tax rate to the estimated total taxable income for each of the military pay grades. This calculation produced both a weighted effective state tax rate of approximately 1.7 percent and an estimated state tax liability for all military personnel of \$297 million.

3. *Estimated the required reduction in state tax liability to reflect the absence of an income tax in ten states, the fully exempt status of military pay in five states, and the less than full taxation of military active duty pay in 16 other states.* This downward adjustment reduced the estimated state income tax due by 58 percent leaving a residual state income tax liability of \$125 million, assuming 100 percent compliance in the District of Columbia and 19 states that tax active duty military pay.
4. *Estimated the state income tax loss due to non-compliance by applying the Minnesota non-compliance rate of 75 percent to the estimated state income tax due (\$125 million) which results in a tax loss estimate of \$94 million.*⁴⁵ Minnesota experience was utilized because it was the only state that provided detailed compliance information. Moreover, that state has a reputation for effective tax administration.

The estimated \$94 million state revenue loss is conservative because:

1. It takes no account of the non-military income of military personnel and spouses which in turn has the effect of understating the real effective tax rate applicable to military income.
2. For states that partially exempt military pay, the estimate excludes a liberal 90 percent of the computed potential state tax liability of military personnel for nine states and from 65 percent down to 10 percent of the computed potential liability of military personnel for the remaining seven states.
3. The estimate makes no correction for domiciliary claims made in order to evade state income tax liability.

It is clear the adoption of state-local withholding on military pay would produce additional state-local tax revenue. Judging by the degree of compliance currently being achieved in Minnesota, withholding should bring about about a 200 to 300 percent rise in compliance by military

members with state income tax laws. This increased compliance would be further enhanced by replacing the subjective judgment of domicile for tax purposes with the objective determination of physical presence at the location where military pay is received. Withholding would also lead to a more accurate determination of state tax liability for military members; the final determination of the military member's tax liability would be on the basis of a return that included income from all sources and excluded that portion of income allowed by state law. As a result of the full reporting of income from all sources on a state tax return, many military members would find themselves in higher state tax brackets.

If no distinctions were drawn between military pay and other income for determining state-local jurisdiction to tax, first preference for taxation would go to the place of actual residence and/or where income is derived (*i.e.*, a civilian, or physical presence, rule would govern). Withholding would presumably apply to all types of earned income. If more than one state established the right to tax (including the domicile state), a system of credits and reciprocal agreements would protect against double taxation, as with civilians.

Tax Base Erosion

For various reasons, about half of the 40 states with broad-based income taxes provide for less comprehensive taxation of military pay than does the Federal government.⁴⁶ Confronted with the administrative and compliance difficulties inherent in the taxation of military pay under current Federal statutes, three states have long since decided to exempt military pay attributable to service outside the domicile state in the interest of treating military personnel as they treat civilians. In a half dozen other states, tax statutes appear to have this effect for many service persons. In at least two other states, similar legislation has been proposed.⁴⁷ Six states have sought to avoid inequitable tax treatment that must be accorded military personnel stationed at the same base but domiciled in different states by exempting military pay from their state income tax.⁴⁸ These state tax policies directly reduce the state's income tax base and raise questions of tax equity.

From the standpoint of the domicile state, exempting military pay earned outside the state by persons stationed outside the state (and having

no dependents in the domicile state) actually represents an improvement in tax equity by the benefits-received rationale of taxation. But from the broader national perspective, such exemption diminishes equity by totally excluding some income flows from taxation.

The exemption or exclusion of military pay from a state's income tax may also constitute an opening wedge for further tax base erosion by giving other groups an issue upon which to seize and argue that they, too, are "different" and deserving of preferential tax treatment. For example, in 1972 when a bill that would have fully exempted military pay from the Ohio income tax came before the legislature, spokesmen for police and firemen who assumed that the proposed military pay exemption was based at least in part on a public-service rationale argued that they were at least as deserving of such preferential tax treatment as the military.

Exemption of military pay usually finds its justification either in patriotism or for administrative-compliance ease. The first argues that full or partial exemption of military pay is a desirable expression of public gratitude toward the men and women serving their country in the armed forces. The second rests on practical concerns. It is often difficult for the state to collect the income tax from domiciliaries stationed outside the state. The absence of withholding makes this doubly true. Tax administrators, politicians, and military personnel all wish to avoid the hardship entailed in confronting a serviceman with a tax bill for several years' unpaid taxes.

The rationale for exempting military pay earned outside the state is buttressed by the benefits-received theory of taxation. Because military personnel stationed outside a given state are unlikely to be receiving significant benefits from the state's services, exempting their pay from the state income tax might be considered simple justice.

Similarly, an equity argument can be made for full exemption of military pay, given the tax treatment mandated by the *Soldiers' and Sailors' Civil Relief Act*. Because this Federal statute makes it impossible to tax all military personnel stationed within a given state, it can be argued that taxing some of them (those domiciled in the state where they are stationed) constitutes inequitable treatment of those persons (compared to other military persons living and working in the same

place). Although full exemption of military pay can be viewed as a remedy to this Federally mandated inequity, it worsens another type of inequity — that between civilians and the military.

Military pay now represents a sizable income stream, and its exclusion from a jurisdiction's income tax base represents significant and undesirable base erosion — more significant in some states and localities than in others.

CONSEQUENCES OF ENDING RESTRICTIONS

The current domicile-only jurisdictional rule offers two principal advantages to military personnel: it protects against double taxation (taxation by both the domicile state and the state where the person is stationed) of the same military pay, and it avoids the possibility of having to file income tax returns for military pay in more than one state. Defenders of this rule argue that it is justified by the special characteristics of military service — relative mobility and absence from the domicile state.

Double Taxation?

If military pay were subject to the same tax rules as earned, civilian income, it would not create a new type of problem. In our mobile society, many people make interstate moves for a period of a year or two or three, and then relocate more permanently again. Some regard their moves as strictly temporary (no domicile change) while others treat them as "permanent" (domicile is changed). Still other persons regularly live in one state and work in another, and thus become subject to tax in two states. States have worked out credit and reciprocity arrangements to protect persons in such circumstances from double taxation of the same income.

All states with broad-based income taxes now provide a credit for taxes paid on earned income to other states by a resident of the state granting the credit.⁴⁹ While credits do not protect against the need to file in two states, they do serve to set a maximum tax liability no higher than the higher of the two states' taxes.⁵⁰ In addition, several states, particularly in the Midwest and the East, have entered into reciprocal agreements that offer even fuller protection, including protection against double filing on earned income.

These provisions could — and would — apply to the military if the domicile-state-only rule were dropped.

Tax credits do not, as a rule, protect against the need to file in two states, and in this regard the domicile-only rule may be said to be superior to the civilian (physical presence) jurisdictional rule. While a jurisdictional rule change undeniably would cause some military persons to come under the jurisdiction of more than one state income tax for the first time, this would not be the case for many of the military.

Those unaffected by a change in the domicile-only rule would include military persons either domiciled or stationed in a state with no personal income tax or an income tax state that continues to exempt military pay. In addition, a large group of military persons currently face multiple-filing requirements because they have a tax obligation to their domicile state for active duty military pay and to the state in which they currently reside for earned income other than military pay either as a result of a second job or of a working spouse. The current jurisdictional rule thus protects a military family against double taxation or double filing only insofar as military pay is concerned; military families (or single individuals) with other income already may be subject to multiple filing requirements.

The compliance problems faced by the military currently subject to multiple filing requirements are more complex now than they would be if the domicile-only jurisdictional rule were ended. Each of the state income tax returns require reports of different amounts of income. Only the domicile state return may include military pay. Exclusion of military pay from the tax return filed with the state where the military family currently lives and/or works may affect a couple's ability to file a joint state income tax return.

If military pay were subject to the civilian-type jurisdictional standard, different persons would be differently affected. For some, there would be no change. For others, state income tax filing would be simplified. And for others, the necessity of filing two state income tax returns would arise.

Withholding?

The two principal arguments against extending state-local tax withholding to military pay are (a)

that the administrative costs imposed on the Armed Services would be too great, and (b) that withholding is not necessary.

Too Costly? The Department of Defense estimated that withholding of state income taxes would necessitate additional annual payroll costs of \$1.7 million, or less than \$1 per military member. DOD also forecast initial start-up costs in excess of \$6 million. All other employers bear the costs of withholding taxes from their employees. Costs of the withholding system must be weighed against the convenience to the military member of meeting tax liabilities currently and the state-local benefits of increased tax compliance, increased revenue, and a more uniform application of the income tax.

Regardless of what states spend to follow up on military pay information provided by the services, the states could not achieve compliance equal to that which could be attained by the additional annual payroll cost projected by the Pentagon. Thus, withholding is the most cost effective method of tax administration for the inter-governmental system as a whole.

Many thousands of state and local governments incur substantial costs in withholding Federal taxes from their 12 million employees. States and localities might argue that as a matter of inter-governmental comity the Federal government should undertake military withholding because, to the extent that there are unique difficulties involved in taxing the military, they result from Federal actions and policies regarding the nature of military service.

It might be possible to reduce the costs of withholding below the projected level by allowing the services to use a flat percentage of Federal liability in lieu of withholding based on detailed application of state withholding formulas or tables. For example, if Virginia's income tax collections are approximately 20 percent of the Federal collections in Virginia, the Pentagon might be allowed to use 20 percent of a military member's Federal withholding amount to approximate that person's Virginia withholding liability. This approach which is available to private employers in some states might be particularly beneficial in the case of withholding of local income taxes, the costs of which are not included in the Department of Defense estimate cited earlier.

Unnecessary? Opponents of withholding assert that the *OMB Circular A-38* procedure (or its reincarnation in the Pentagon) adequately meets the needs of the state and local income tax agencies. The earlier review of problems with the A-38 process seriously undermine this contention. Even a perfectly functioning A-38 system would not provide the advantages of pay-as-you-go tax payments.

Some support has arisen for expanding the system of voluntary allotments to enable a military member to spread his payment of state-local income taxes over the year, thereby smoothing cash-flow for both the military member and the taxing unit. Allotments already are authorized for such purposes as paying insurance premiums and making savings deposits.

Taxes, by definition, are involuntary contributions in contrast to the payments now subject to voluntary allotment. Such a system could therefore be regarded as no more than a stop-gap measure and not as a substitute for withholding. Moreover, the voluntary allotment approach would entail additional costs. Details of payment frequency and reporting forms would have to be worked out with the governments involved. For those opting for an allotment, the costs might well approximate the relatively low per-member costs estimated for withholding. Because not all military personnel would opt for allotments, the administrative advantages of the voluntary approach would fall far short of the benefits of withholding — especially since those who are most reluctant to pay their state-local taxes probably would not participate in the allotment plan.

Opinions of Armed Forces members shed some additional light on the “need” for withholding. Such information is fragmentary, but it suggests that a large number of military personnel would prefer having withholding. A reporter recently queried more than 80 members drawn from all service branches about state tax withholding on military pay. More than 80 percent of those questioned said they wanted withholding.⁵¹ By his account, most who opposed withholding were officers or senior enlisted men. Yet, a major is quoted as follows: “I would prefer to have it withheld. That way it would soften the blow.”

An E-5 opined, “I’d prefer withholding. I just got a letter from the state saying I have to pay quarterly and they billed me for \$250. Withholding would be less of a hassle. It would make us like everyone else in the civilian community.”

Garnishment Contributes to Enforcement

It is unseemly from an intergovernmental perspective for Federal employees to be able to ignore with impunity legitimate court orders to pay state-local obligations. State and local agencies accept Federal income tax notices of levy and hold the taxes due out of their employees’ paychecks. The Federal government should not allow the doctrine of Federal immunity to continue to shield willful tax evaders. Moreover, Federal agencies under the terms of P.L. 93-647 now accept and act upon state court orders to garnish wages to settle child support and alimony awards.

Advocates of retaining immunity for Federal employees from wage garnishment for tax purposes allege that tax officials could, short of formal garnishment procedures, seek employer cooperation in getting the recalcitrant employee to pay his delinquent taxes. Advocates of the garnishment idea argue that the problem with such an approach is that it is likely to be as costly to the employer as garnishment. Another, more crucial, point has been raised by a state tax official:

Military wages cannot be attached. Unless the individual owns property in the state on which levy can be taken, a state is powerless to collect the tax due. Although military officials frequently counter this complaint with a suggestion that state tax authorities ask the individual’s commanding officer to intercede, it is doubtful whether this approach can be effective or legal. In many states such revelations may constitute a breach of the confidentiality provisions of the tax law, especially when such information is made known to non-withholding employers.⁵²

FOOTNOTES

- ¹Any reference to Federal restrictions on state income taxation applies also to local income taxation.
- ²50 Appendix U.S.C., Sec. 574 (1970).
- ³P.L. 587, 82d Cong., Ch. 940, 66 Stat. 765 (1952), relating to withholding, for state income tax purposes, on the compensation of Federal employees; P.L. 460, Ch. 154, 70 Stat. 68 (1956), *District of Columbia Revenue Act of 1956*; and P.L. 93-340, 88 Stat. 294 (1974), an act to amend titles of the U.S. Code (relating to government organization and employees) to assist Federal employees in meeting their tax obligations under city ordinances. 93-340 requires that there be at least 500 Federal civilian employees in the taxing unit before local tax withholding will be undertaken.
- ⁴For summaries of the types of definitions, see: Advisory Commission on Intergovernmental Relations, *Federal-State Coordination of Personal Income Taxes*, A-27 (Washington: U.S. Government Printing Office, 1965), pp. 148-49; and Jerome R. Hellerstein, *State and Local Taxation Cases and Materials*, 3rd ed. (St. Paul: West Publishing Company, 1969), p. 618.
- ⁵Connecticut, General Assembly, Joint Committee on Legislative Management, Office of Legislative Research, "The Definition of 'Resident' in Selected States" (Hartford: Connecticut Office of Legislative Research; processed; April 13, 1971), p. 1, quoting *Black's Law Dictionary*.
- ⁶*Ibid.*, p. 2, quoting *American Jurisprudence — Elections*.
- ⁷50 Appendix U.S.C., Sec. 574 (1970).
- ⁸*All States Income Tax Guide*, 1975 Edition for 1974 Returns (Washington: U.S. Air Force, Office of the Judge Advocate General; undated), p. iii.
- ⁹*Op. Cit.*, Connecticut Office of Legislative Research, "The Definition of 'Resident'"
- ¹⁰See footnote 3.
- ¹¹See U.S. Congress, General Accounting Office, *A Case for Providing Pay-As-You-Go Privileges to Military Personnel for State Income Taxes*, A Report to Congress by the Comptroller General of the United States. A copy is appended to this report.
- ¹²Quoted in Andy Plattner, "Troops Back State Withholding," *Army Times*, November 5, 1975, p. 12.
- ¹³Advisory Commission on Intergovernmental Relations, *Federal-State-Local Finances: Significant Features of Fiscal Federalism*, 1973-74 edition, M-79 (Washington: U.S. Government Printing Office, 1974), Table 96. (Hawaii is included in the 1940 figure.)
- ¹⁴*Ibid.*, Table 23.
- ¹⁵U.S. Bureau of the Census, *Governmental Finances in 1973-74*, GF 73 No. 5 (Washington: Government Printing Office, 1974), Table 4, p. 20.
- ¹⁶This group is of special interest since, under a strict physical presence jurisdictional standard, persons not living in the United States would not have a tax obligation to the states.
- ¹⁷*Military Market Facts Book: 1973* (Washington: Army Times Publishing Company, undated), p. 89.
- ¹⁸*Ibid.*, p. 84. The issue of on- or off-base housing is not critical to the taxation issue since (a) from an equity standpoint, many government services funded by income taxes are available to persons who may not live in the private community; and (b) from a legal standpoint, the *Buck Act* extends the reach of state income taxes even to civilians living on land under Federal jurisdiction.
- ¹⁹*Ibid.*, p. 68.
- ²⁰Data supplied in attachment to letter dated August 16, 1974, from former Secretary of the Army Howard H. Callaway to former ACIR Executive Director William R. MacDougall.
- ²¹Estimates contained in "Statement of Vice Admiral John G. Finneran, U.S.N., Deputy Assistant Secretary of Defense (Military Personnel Policy), Office of Assistant Secretary of Defense (M & RA), before the Advisory Commission on Intergovernmental Relations, September 11, 1975" (processed). This statement is appended to this report.
- ²²Quoted from "Comments on Differential State and Local Taxation of Military Personnel before the Advisory Commission on Intergovernmental Relations in Washington, D.C., on September 11, 1975," by Daniel G. Smith, Administrator, Income, Sales, Inheritance, and Excise Taxes, Wisconsin Department of Revenue (processed). This statement is appended to this report.
- ²³State income tax provisions pertaining to military pay are discussed in the section on the compliance problem and are presented in *Appendix B*.
- ²⁴The *Soldiers' and Sailors' Civil Relief Act* accords the same treatment to personal property for non-domiciliary military personnel, so jurisdictions levying personal property taxes experience the same effect as those levying personal income taxes. Moreover, as discussed elsewhere in this report, other Federal laws and practices reduce military payments of sales and excise taxes.
- ²⁵Based on "Defense Personnel and Total Population in the United States by State as of June 30, 1973" (Washington: Department of Defense, OASD (Comptroller), Directorate for Information Operations, November 15, 1973).
- ²⁶In Maryland, counties impose piggyback income taxes, typically at 50 percent of the state tax. Thus, the counties and Baltimore City also would gain revenue if military pay were taxable in the same manner as civilian pay. Local taxes are not included in the estimate.
- ²⁷The number of military personnel present in Maryland is based on the Census concept (resident) rather than on the basis of location of the duty assignment (place of work). The number of military personnel residing in Maryland is greater than the number stationed at Maryland bases. Because the number of persons in the military has declined since 1970, the number of Armed Forces personnel in Maryland in the 1970 *Census of Population* (65,601) was reduced by 22 percent (the average decline in U.S.-based Armed Forces personnel between 1970 and 1974) to 51,169. Average basic pay (*i.e.*, taxable pay) per military person in 1972 was calculated conservatively at \$7,553, a figure which was adjusted upwards by 19.55 percent (to \$9,030) to reflect the average increase in basic pay between 1972 and 1974-75. To this estimated taxable military pay level was applied an effective state income tax rate of 2.2 percent, yielding an average state income liability of about \$199. This figure times the estimated number of military persons (51,169) produces an estimated aggregate Maryland state income tax liability for military personnel living in the state of \$10.2 million.

The figures are imprecise because of the extensive use of averages; only a rough order of magnitude is indicated by the estimate. (Size of the Maryland military population is from U.S. Bureau of the Census, *Census of Population: 1970*, Vol. 1, *Characteristics of the Population*, Part 22 (Washington: U.S. Government Printing Office, 1973), Table 53; data on overall military strength in U.S. and military pay levels are from the Office of the Assistant Secretary of Defense (Manpower and Reserve Affairs) and from the *Military Market Facts Book*, pp. 67, 122, and 268; the change in basic pay between 1972 and 1974-75 is based on Office of Management and Budget data; and the effective tax rate information is based on ACIR, *Federal-State-Local Finances*, Table 139.)

²⁸OMB rescinded *Circular A-38* in September 1975, citing difficulties with the *Privacy Act*, which became effective in that month. The Department of Defense, however, announced in November 1975 that it had determined that it could, and would, continue to supply the W-2 information on its own authority. These announcements were contained, respectively, in: (a) a September 25, 1975, memorandum "To the Heads of Executive Departments and Establishments" from OMB Director James T. Lynn; and (b) a November 7, 1975, Department of Defense news release "For Correspondents."

²⁹U.S. Office of Management and Budget, *Circular No. A-38 Revised* (Washington: OMB, March 25, 1974; processed), pp. 3-4. For convenience, these forms are called W-2s in this report.

³⁰The figures for Maryland and the District of Columbia used in this section were supplied to ACIR by the District of Columbia Department of Finance and Revenue. They are also contained in GAO, *Case for Providing Pay-As-You-Go Privileges*. This report is appended to this document.

³¹28,858 wage statements were sent to Minnesota for 1974 for active duty members of the Air Force, Army, Marine Corps, and Navy, according to data supplied to the ACIR by the Office of the Assistant Secretary of Defense (Manpower and Reserve Affairs) in April and May, 1975. The state's prorata share of Armed Forces personnel serving overseas is estimated at 9,500.

³²Minnesota Department of Revenue submission to ACIR, July 1975.

³³W. A. Barnes, "Withholding of State Income Taxes on Wages of Military Personnel," paper presented at the 1975 annual meeting of the National Association of Tax Administrators (processed; June 1975), p. 3.

³⁴ACIR, *Federal-State-Local Finances*, Table 96. Basic information on state income tax provisions relating to military pay is from *All States Income Tax Guide*.

³⁵In these six states a domiciliary stationed outside the state may have no tax liability to the state if he meets certain residency requirements, typically that the person (a) maintains no permanent place of abode in the state, (b) does maintain a permanent place of abode elsewhere, and (c) is in the state less than 30 days of the year. (Based on *All States Income Tax Guide*.) In these states the same provisions apply to civilians. Other states have such provisions for civilians but do not apply them to the military because of the domicile-only rule pertaining to military pay.

³⁶Air Force, Marine Corps, and Navy data in *Table 7* are

simply tabulations of the state-by-state figures supplied to ACIR by the respective services through the Office of the Assistant Secretary of Defense (Manpower and Reserve Affairs). The Army, however, supplied figures on the number of wage statements sent under A-38 only for 38 states and the District of Columbia, so it was necessary to estimate the number of Army personnel claiming domicile in the other 12 states.

The basic relationship used in making the estimate was that between the number of personnel actually serving in the United States (50 states and D.C.) as of June 30, 1974, and the number of wage statements sent under A-38 (which does not cover overseas personnel) for 1974 (all data supplied by the Department of Defense). For the Air Force, Marine Corps, and Navy the ratios of wage statements to mid-year actual strengths were 1.25, 1.43, and 1.22, respectively. The simple average of these is 1.30, the weighted average, 1.26. It was assumed, therefore, that the number of legal residence claims (wage statements) for the Army would have been 25 percent higher than the mid-year actual strength, had the Army kept records for all 50 states as the other three services did. The 25 percent figure used approximates the weighted average relationship for the other three services, is the figure indicated for the Air Force (which is perhaps more similar to the Army than are the other two services), and is more conservative than the simple average.

The number of legal residence claims for the 12 unreported states was derived by subtracting from the estimated grand total (estimated as just described) the number reported for the other 38 states and D.C. The 12 unreported states fall into three of the six groups in *Table 7* — all ten no-tax states in the first group, Vermont in the second group, and Rhode Island in the fourth group. It was estimated that these 12 jointly accounted for 44.9 percent of Army legal residence claims in 1974. Because all except Vermont and Rhode Island fall in a single group, and because Vermont and Rhode Island are small (0.7 percent of U.S. population in 1973), each of these two states arbitrarily was assumed to account for the same percentage of legal residence claims as their respective percentages of populations, thereby leaving 44.2 percent of the Army legal residence claims in the ten no-tax states. The number of legal residence claims attributed to Vermont and Rhode Island could be made a multiple of their population shares without significantly reducing the general magnitude of the share of legal residence claims estimated for the no-tax states.

³⁷Calculated from: OASD(C), "Defense Personnel and Total Population in the United States by State, as of June 30, 1973."

³⁸Based on information supplied, in response to an ACIR request, by the individual services through the Office of the Assistant Secretary of Defense (Manpower and Reserve Affairs).

³⁹See footnote 28.

⁴⁰The provisions relating specifically to the military are in item 6a of the latest (March 25, 1974) version of *Circular A-38*.

⁴¹*All States Income Tax Guide*, p. ii.

⁴²June 10, 1975, packet of materials pertaining to military wage statements sent to ACIR by the Wisconsin Depart-

ment of Revenue. This information also appears in Smith, "Comments on Differential State and Local Taxation," esp. Table 1, which is appended to this report.

⁴³*Ibid.*

⁴⁴*Ibid.*

⁴⁵See footnote 31.

⁴⁶The focus is on active duty pay in non-combat zones. Special provisions (*i.e.*, differing from Federal) for combat pay and retirement pay are not included in these figures. Federal law excludes all pay for service in a Presidential designated combat zone for enlisted personnel and up to \$500 per month for officers in determining Federal income tax liability; the same provisions pertain to pay drawn while hospitalized due to injuries sustained while serving in a combat zone. Pay for persons who are prisoners of war or missing in action also is exempt for the period of POW/MIA status. In addition, housing and subsistence allowances are not taxable.

⁴⁷For example, H.B. 269 in the 1975 Hawaii legislative session and H.B. 5017 in the 1975 Rhode Island legislative session both proposed such exemption. *State Tax Review* for

March 4, 1975 (p. 3), and March 11, 1975 (p. 12), respectively (Chicago: Commerce Clearing House).

⁴⁸In addition to the five states providing full military pay exemptions for tax year 1974 (see *Appendix B*), H.B. 152 adopted in Montana in 1975 provides for full exemption of military pay under that state's income tax. (*State Tax Review*, April 22, 1975 (Chicago: Commerce Clearing House, p. 4).) Similar bills were introduced in other states, including New York (S.B. 1343 and A.B. 1274) and Wisconsin (S.B. 9). (*State Tax Review* for March 11, 1975 (p. 11), and for May 27, 1975 (p. 7), respectively (Chicago: Commerce Clearing House).)

⁴⁹*State Tax Guide*, 2nd ed. (Chicago: Commerce Clearing House), p. 1543 dated June 1975.

⁵⁰ACIR, *Federal-State Coordination of Personal Income Taxes*, pp. 142-46, contains a discussion of crediting arrangements.

⁵¹*Op. cit.*, Plattner, "Troops Back State Withholding."

⁵²Smith, "Comment on Differential State and Local Taxation," p. 5.

Appendixes

Appendix A. Selected Statistics on Military and Civilian Compensation	45
Appendix B. Summary of State Laws Granting Tax Advantages to Military Personnel	47
Appendix C. Testimony before the Advisory Commission on Intergovernmental Relations, September 11, 1975	51
Vice Admiral John G. Finneran, Assistant Secretary of Defense for Manpower and Reserve Affairs.	52
Colonel F. Meyer, Jr., Legislative Counsel, The Retired Officers Association.	60
Robert Fitzgerald, Legislative Counsel, The National Association for Uniformed Services	62
C. A. "Mack" McKinney, Director of Legislative Affairs, Non Commissioned Officers Association	64
Charles F. Conlon, Executive Secretary, National Association of Tax Administrators.	76
William H. Forst, Tax Commissioner, Virginia Department of Taxation.	77
William Barnes, Chief of Sales and Income Tax, Mississippi Tax Commission.	78
Eldred J. Kelley, Staff Assistant, Excise Taxes, California State Board of Equalization	80
Daniel G. Smith, Administrator, Income, Sales, Inheritance and Excise Taxes, Wisconsin Department of Taxation	82
Robert J. Woolsey, Director of Tobacco Products Tax Division, Comptroller of Public Accounts, Austin, Texas	88
National Tobacco Tax Association.	91
Statement Submitted by the American Logistics Association.	94
Appendix D. A Report to the Congress by the Comptroller General of the United States.	97
<i>A Case for Providing Pay-as-You-Go Privileges to Military Personnel for State Income Taxes, November 19, 1975.</i>	

Appendix A

**Selected Statistics of
Military and Civilian Compensation**

Appendix A

Indices of Military Pay, Civilian Pay, and Government Purchase Prices: 1946-1973

Pay and purchase price indices (FY 1964 = 100)

Fiscal year	Military basic pay ^a	Classified civilian salaries ^a	Purchase prices ^b
1946	48.0	50.2	
1947	59.4	57.4	
1948	59.4	57.4	
1949	59.4	63.7	78.2
1950	69.6	65.4	76.2
1951	73.0	66.3	83.3
1952	73.5	72.9	83.1
1953	75.9	72.9	82.3
1954	75.9	72.9	80.6
1955	77.8	74.7	84.6
1956	83.5	78.4	88.8
1957	83.5	78.4	94.9
1958	84.1	82.3	96.2
1959	90.4	86.3	98.1
1960	90.4	86.3	97.6
1961	90.4	92.9	99.3
1962	90.4	92.9	98.9
1963	90.4	96.5	99.4
1964	100.0	100.0	100.0
1965	105.6	106.3	102.3
1966	116.6	109.2	104.2
1967	120.3	113.3	106.8
1968	125.3	117.1	109.6
1969	135.8	124.2	113.7
1970	159.1	139.6	118.7
1971	171.9	147.9	125.3
1972 ^c	198.5	156.4	129.9
1973 ^c	224.8	164.5	133.5

^a Military basic pay and civilian salaries are not comparable. A 4 percent increase in basic pay is approximately equivalent to a 3 percent salary increase.

^b Non-compensation component of the deflator for Federal purchases of goods and services. Source: 1949-71, Department of Commerce, FY 1972 and FY 1973, estimated (3.7 percent increase for FY 1972 and 2.8 percent increase for FY 1973).

^c Reflects 1-1-72 pay raise and assumes slightly smaller pay raise 1-1-73, plus enactment of proposed volunteer-related pay legislation effective 7-1-72.

SOURCE: *The Economics of Defense Spending: A Look at the Realities* (Washington: U.S. Department of Defense, Assistant Secretary of Defense [Comptroller], 1972, Table 15-3, p. 134.

Appendix B

**Summary of State Laws
Granting Tax Advantages
To Military Personnel**

Appendix B

**Summary of State Laws Granting Tax
Advantages To Military Personnel¹**

Alaska:

All military pay exempt from state income taxation; military personnel also exempted from payment of state school taxes.

Arizona:

The first \$1,000 of military active duty pay exempt from income taxation.

Arkansas:

The first \$6,000 of military pay or allowances excluded from income tax.

California:

First \$1,000 of military pay excluded. Also, California residents in military who leave California under permanent change of station orders become non-residents for income tax purposes, taxable only on income from California sources (under community property law, however, one-half of military pay from service outside California would be taxable in California if spouse remains there).

Idaho:

Military pay not taxable if stationed outside Idaho.

Illinois:

Military pay not taxed.

Indiana:

First \$2,000 of military pay excluded.

Iowa:

Military pay not taxed.

Maine:

Depending upon residency definitions and tests pertaining to place of abode and length of time within the state, Maine domiciliaries stationed outside Maine may be exempt from the Maine income tax on their military pay.

Michigan:

Military pay not taxed.

Minnesota:

First \$3,000 of military pay not taxed if service is in Minnesota; first \$5,000 if outside Minnesota.

Missouri:

Depending upon residency definitions and tests pertaining to place of abode and length of time within the state, Missouri domiciliaries stationed outside Missouri may be exempt from the Missouri income tax on their military pay.

*New Hampshire:*²

Military pay not taxed.

*New Jersey:*²

Active duty pay not taxed.

New York:

Depending upon residence definitions and test pertaining to place of abode and length of time within the state, New York domiciliaries stationed outside New York may be exempt from the New York income tax on their military pay.

North Dakota:

First \$1,000 of military pay excluded.

Oklahoma:

First \$1,500 of military pay not taxed.

Oregon:

First \$3,000 of military active duty pay not taxed. Moreover, depending upon residency definitions and tests pertaining to place of abode and length of time within the state, Oregon domiciliaries stationed outside Oregon may be exempt from the Oregon income tax on their military pay.

Pennsylvania:

Military pay not taxable if stationed outside Pennsylvania.

Rhode Island:

Depending upon residency definitions and tests pertaining to place of abode and length of time within the state, Rhode Island domiciliaries stationed outside Rhode Island may be exempt from the Rhode Island income tax on their military pay.

Vermont:

Military pay not taxed.

West Virginia:

First \$4,000 of military pay not taxable. Moreover, depending upon residency definitions and tests pertaining to place of abode and length of time within the state, West Virginia domiciliaries stationed outside West Virginia may be exempt from the West Virginia income tax on their military pay.

Wisconsin:

First \$1,000 of military pay not taxed.

¹Only states that have laws which treat military pay significantly different from the Federal income tax provisions are shown here. Also, the focus here is on active duty pay, ignoring retirement benefits, *G.I. Bill* benefits, etc. Combat pay exclusions more generous than those in Federal law also are not covered here (including Colorado's, which extends to income for a period of 180 days following service in a combat zone).

²The income taxes of these states are not broad-based taxes; most persons in these states have no income tax liability to the state.

SOURCE: *All States Income Tax Guide*, 1975 edition for 1974 returns (Washington: United States Air Force, Office of the Judge Advocate General, undated).

Appendix C

Testimony Before the
Advisory Commission on Intergovernmental Relations
September 11, 1975

Statement of
Vice Admiral John G. Finneran
United States Navy Deputy Assistant Secretary of Defense
(Military Personnel Policy)
Office of Assistant Secretary of Defense (M&RA)

I am Vice Admiral John G. Finneran, deputy assistant secretary of defense for military personnel policy. I appreciate the opportunity to present the views of the Department of Defense on the ACIR report entitled *Differential State and Local Taxation of Military Personnel: An Intergovernmental Problem*.

The report, as you know, addresses two basic questions:

First, should the *Buck Act* be amended to allow state and local taxation of military store sales?

Second, should the *Soldiers' and Sailors' Civil Relief Act* be amended to end the differential state-local income tax treatment of military persons?

Because of the complexity of this latter issue and with your forbearance, I will address the state and local income taxation issue first.

State-Local Taxation of Military Pay

I want to first assure you that it is Department of Defense policy that our military members comply with tax obligations that might apply to them, whether Federal, state, or local. Because of the provisions of 5 U.S.C. 5517, which preclude the Secretary of the Treasury from entering into agreement with any state for the withholding of state income taxes from military pay, such income tax returns are thus a matter largely between the individual member and the state claimed as his legal domicile. Nevertheless, the Department of Defense 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. For your review, I have attached a listing of representative publications and other media means used in this continuing information and education effort.

Before addressing the major issues in the second question, I believe it would be of assistance in your deliberations if you understood the requirement for mobility in the military. Although we now have an all-volunteer force structure and the Vietnam conflict is over, there are still overriding requirements that necessitate frequent moves by many of our military members. Accessions and separations are expected to account for over one-half of the approximately 1.8 million military moves projected for Fiscal Year 1976. Many will be attributable to our military training programs which are essential to our maintaining combat ready forces. Other moves are required in order to rotate our troops into and out of overseas assignments and duty onboard ships of the Navy. In short, although we are taking every initiative to reduce personnel turbulence, the nature of military service and our worldwide commitments dictate the mobility we have and will continue to experience. These requirements contribute substantially to the unique character of military service and impact on the military member and his family.

At this point I will address each of the major issues in the same sequence as they appeared in the ACIR report.

With regard to the jurisdictional issue, any change to the *Soldiers' and Sailors' Civil Relief Act* to allow the state in which a military member is ordered to serve to impose state income taxes upon his military pay would cause the military departments, our military members, and many states additional problems possibly not fully considered in the report.

I will first address the aspects of the problem of overriding concern to us: the possible impact on our military personnel. Perhaps of primary concern is the likelihood that many of our members would have to file multiple tax returns if required to pay taxes to each taxing state in which ordered to serve. For example, the Army projects that more than 220,000 recruits will undergo initial entry training in Fiscal Year 1976. For the great majority of these, this includes basic combat training and advanced individual training before joining a permanent unit of assignment.

Let us look at a hypothetical case. A recruit enters active duty from the State of Oklahoma in March 1975. During the months of January and February he had been employed in Oklahoma where taxes were withheld. He attended basic combat training at Ft. Polk, Louisiana, for a period of eight weeks, and then went to advanced individual training at Ft. Eustice, Virginia, for a period of 14 weeks. Upon completion of this training, he was given 30 days leave before reporting for permanent assignment to Ft. Bragg, North Carolina. In this case, the recruit might be required to file as many as four state income tax returns for the 1975 tax year if he were subject to taxation by the state in which ordered to serve. We are unsure of the tax treatment of pay received while on leave.

Not all cases would be so severe depending on the tax laws, or absence thereof, of the states in which personnel are ordered to train and permanently serve or the time of year that military service is commenced. Chances are, however, that many recruits, not just Army, would be required to file multiple tax returns in relationship to initial entry training and permanent assignment. This would place an unusually complex burden on those least capable to deal with such problems due to youth, inexperience, and lack of advanced education.

In addition, the Army alone projects that more than 300,000 of its members will attend various courses of military instruction during Fiscal Year 1976. These courses are of various duration and in numerous states. Again, it can be seen, using only the Army as an example, that many thousands of our careerists would also be required to file multiple tax returns as a result of attending military courses of instruction.

The sheer volume involved in military courses of instruction, coupled with approximately 830,000 permanent change of station moves (less accessions and separations moves) projected for Fiscal Year 1976, provide some idea of the magnitude of the administrative complexities involved should the *Soldiers' and Sailors' Civil Relief Act* be amended as proposed. Under the circumstances expected to result from such change, it would be virtually impossible for state tax administrators to identify those who should be filing, to get forms to them, to collect the taxes due, and to audit the taxpayers.

There are also other numerous problems that the proposed amendment to the *Soldiers' and Sailors' Civil Relief Act* could present to our members. A number of these are mentioned in the report but are largely glossed over as situations that will probably be rectified by the states. The following are but a few of the potential problems that still concern us:

—The member could be disinclined to take the opportunity to maintain a permanent domicile some place so that he may be entitled to exercise the right to vote, to pass property by a will, to claim resident tuition rates, to become licensed in certain professions, and to title his personal property.

—Most states currently require a minimum of one-year's residence in the state, and verify this against tax returns, before according resident tuition rates at state colleges and universities. A member serving overseas or at a stateside station for a short period before discharge could be denied resident tuition rates in any state.

—A member could be required to license his car and obtain a driver's license in each state in which he serves. Under current law he may do both in his state of legal domicile and if moved frequently does not have to relicense in each new state.

—If taxes are withheld and paid to a member's host state, there is a question as to whether the laws of that state will be controlling for purposes of disposition of one's property by will. It could be that a member would be required to redo or add codicils to a will each time he or she is transferred to a different state.

—Proof of domicile could be affected for purposes of claiming state veteran bonuses.

—Some states exempt the capital gain tax on the sale of personal residence only if another home is purchased within the same state, whereas others follow the Federal rule and exempt the capital gain if he purchases a new home, no matter where. It could be that if a member sells his residence because of being transferred, through no choice of his own, he might end up paying the capital gain in the host state, although in his original state of legal domicile it is not taxable.

—If a member owns a home in his original state of legal domicile (Nebraska) and is paying taxes and interest on it, he might not be able to claim these as tax deductions if stationed in Minnesota, for example, but could claim them if stationed in Virginia and could clearly claim them if filing and paying

taxes to Nebraska. Here again, we would find inequities through no fault of the member.

—Some states have six months or 183 days grace periods before any tax is due. Others require taxes no matter how long the period in the state. This would add to the administrative burden of withholding and could work to the disadvantage of the member. For instance, taxes withheld when a member is assigned for less than 183 days in a state where such rule applies could not be requested for refund by the member until the following year.

—Serving in a state which does not impose an income tax on military pay would be highly advantageous whereas service in a state which taxes such pay would be looked upon as disadvantageous. A serious morale problem could result from such inequitable treatment, and this could impact adversely on our all-volunteer force objectives. It should be borne in mind that the military member, unlike civilian employees, generally has no option as to where he serves as he is ordered to move where the needs of the Service dictate his presence.

Next, I will mention several problems that might be encountered by the various states should the *Soldiers' and Sailors' Civil Relief Act* be amended as proposed. Some of these are presented in the report, but generally in insufficient detail to assess the impact.

First, under such proposal a military member serving overseas or aboard ship would not pay income taxes to any state, whereas many now do. Considering that about 500,000 of our members are so serving, which is about 25 percent of our total force, it would appear that there could be a considerable revenue loss to those states that currently impose income taxes on military pay. Further, if the member goes overseas and his dependents remain in the United States, since the tax would be withheld and payable wherever he was stationed, there would be no tax paid to the state where his dependents reside, although they would be using the facilities of that state. It should be noted that there are numerous stations overseas, and of course on board ship, where dependents are not authorized.

If section 514 of the *Soldiers' and Sailors' Civil Relief Act* were amended as suggested, state income tax revenues might be further eroded by the fact that there are about 300,000 military members, or roughly 20 percent of those serving in the United States, who serve in the seven states which do not impose any income tax.

Lastly, it might also be pointed out that under the proposal to amend the *Soldiers' and Sailors' Civil Relief Act*, some of the inland states might suffer a loss in tax revenue in view of the original settlement of a large number of major military installations in coastal states. About 1 million of our approximately 1.5 million military members stationed or home ported in the United States are in coastal states.

In summary, and in consideration of all aspects of the problem, we believe the current protection of the *Soldiers' and Sailors' Civil Relief Act* is the only fair, equitable, and administratively feasible method of imposing state income taxes on members of the military. Therefore, we support the *status quo* argument with regard to the jurisdictional issue.

With respect to the administration and compliance issue, there are significant problems attendant to any proposal to withhold state income taxes from military pay. 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. 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 \$6.3 million. Annual maintenance of the system is estimated at \$1.7 million for all services. These are revised estimates. Although the matter of withholding for local taxes was given little discussion in the report, the problems and costs attendant to withholding for state taxes would probably be increased manyfold in also withholding for local taxes. 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 until such time as the individual states and the Department of Defense have exhausted all efforts to gain compliance through less costly means.

Since 1963, DoD has been providing the states with copies of the Individual Wage and Tax Statements (IRS Form W-2), or similar information on computer listings, for those members serving in the United States, based on the legal residence on record of our members.* Followup efforts by the states for assistance in locating any members failing to promptly file tax returns are believed to have been minimal. For this reason, we do not know the extent to which our members may be in non-compliance. The department is quite concerned by the apparent failure of the states to initiate decisive follow-up action. We are available to assist in locating any potential taxpayers and will provide direct counseling service to advise such members on their tax responsibilities.

Although there is some question as to the legality of the reporting requirements imposed in *OMB Circular A-38*, in accordance with the *Privacy Act*, we are nevertheless of the opinion that alternative arrangements might be made with the IRS to provide them with domicile data, which in turn could be provided the states. Meanwhile, until the legal questions are resolved, we are taking steps to insure that W-2 information provided the states contains current addresses and will include members serving overseas.

Although authorizing voluntary allotments to our members for purposes of meeting state income tax obligations is not without appreciable cost, we believe this alternative to be more favorable than imposing withholding requirements. However, we would strongly object to imposing garnishment procedures against military pay with respect to delinquent tax accounts. The military departments are currently experiencing many administrative difficulties with respect to garnishment for child support and alimony payments in accordance with court orders. To tie up our military pay systems further, with respect to garnishments, would seriously affect our capability to discharge pay responsibilities to our members in a timely manner.

In view of these considerations, and our intent to be as responsive as possible to the requirements of the individual states, the Department of Defense tacitly supports the alternative before the Commission to provide for minimum changes. In consideration of the changes recommended, we believe there would be no undue problems associated with the majority of them, providing there is no conflict with restrictions contained in the *Privacy Act*. It should be noted, however, that implementation of the voluntary allotment system might require as long as 15 months for the Navy since that service is in the midst of converting to a centralized pay system. Further, should this alternative be adopted by the Commission, we do not believe it necessary that Congress instruct the adoption of such voluntary allotment system as this can be implemented by the Department of Defense. Lastly, as a minor issue, we do not agree that records of legal residence be updated annually. Such a requirement might be mis-

*Editor's Note: Shortly after this testimony, the Office of Management and Budget ended its *Circular A-38* to comply with the new Federal Privacy Act.

leading wherein service members might get the impression that they can change their legal residence by merely changing their records.

With regard to the state conformity to Federal tax base issue, we do not necessarily agree with the conclusions drawn in the report that many states that offer military exemptions, in part or in full, do so because of the administrative difficulties involved in effecting tax remittances from military members. The states offering such exemptions have ostensibly done so through the democratic process. It should be noted that eight of the states offering such exemptions and two of the states with no tax provisions whatsoever, also accord Vietnam state bonuses. Only 16 states in total offer such bonuses. This supports the argument that the exemptions or exclusions may have been in recognition of patriotism and the unique service to our nation contributed by state sons and daughters, who are military members, and their families.

We also find fault with the arguments in the report that military service is little different from employment in the private sector and that military pay is more than comparable to pay in the private sector. Of our military members, approximately 52 percent are in the lower four pay grades, with average Regular Military Compensation (RMC), which is comprised of basic pay, the allowances for quarters and subsistence and the tax advantage in that the allowances are tax free, ranging from \$6,300 to \$8,000 annually. Average male individual income for full-time employment in the United States for 1974 was \$12,152. In addition, military service still remains apart in that our 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 court's 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 and they must be prepared to defend their country or die for it if need be. These are but a few of the things that differentiate military service from civilian employment. For these reasons, we are not convinced by arguments in the report for requesting the states with income tax provisions to amend their tax laws, as appropriate, to deny exemptions accorded members of the Armed Forces. Therefore, we believe the present state exemption policies are acceptable and support an alternative maintaining the *status quo*.

Sales and Excise Taxation of On-Base Sales to Military Personnel

I will now take up the section of the report dealing with sales and excise taxation of on-base sales to military personnel.

The position of the Department of Defense is that the *Buck Act* should not be amended to allow state and local taxation of on-base sales in military stores. The Supreme Court has repeatedly adhered to the view that the inapplicability of state and local taxes to on-base sales by Federal instrumentalities is the result of sovereign immunity. As recently as June 2 this year, in the case of the *United States versus the Mississippi Tax Commission*, the Supreme Court ruled unconstitutional a tax imposed by Mississippi on liquor sold on military installations. As a part of its findings, the Supreme Court held that Section 107(a) of the *Buck Act* ". . . can only be read as an explicit Congressional preservation of Federal immunity from state sales taxes [as] unconstitutional under the immunity doctrine announced by Chief Justice Marshall in *McCulloch versus Maryland*." We believe Congress should continue to preserve that immunity.

There are several matters in the report dealing with this question with which we have serious reservation.

At the outset, the report states that an examination of tax problem is called for by the substantial alteration of pay and conditions of service for military persons implemented since the adoption of the all-volunteer Armed Forces concept.

There is no doubt that pay has improved for the Armed Forces in recent years, but as Defense Department representatives have repeatedly stated, this correction of inequitably low-pay scales was needed irrespective of continuation of the draft or the national decision to implement an all-volunteer force.

There is no doubt that in many respects we have improved the conditions of service life in the relative peacetime environment following Vietnam.

What has not changed, however, is the nature of service life. As stated earlier, service life is still very different from civilian life in many respects. We ask more of our uniformed people than we do of civilians. Military persons go where they are needed when they are needed in compliance with orders and frequently sacrifice amenities available to the private citizen in responding to these requirements. The report strongly infers that competitive pay and improved living conditions warrant elimination of differential tax treatment. Aside from the basic question of constitutionality, we support the view that the different nature of service life warrants continuation of existing laws pertaining to state and local taxes on military store sales. We take exception to the statement in the report that there is “. . . no objective way to evaluate the argument that military people are not comparable to civilians.” The very nature of service expected of uniformed men and women makes lack of total comparability self-evident.

There is another dimension to the different nature of service life. The service member is politically different. He is not necessarily permitted to vote where he is stationed and his political activities are more restricted than those of other citizens. Further, as the report does point out, military persons often do not make the same use of state and local public services as civilians. Imposition of state and local sales taxes implies that military persons would receive equal local benefits from those taxes and would have an equal voice in how those taxes are spent. Neither would be uniformly true.

One of the alternative recommendations in the report would maintain the state-local tax exemption only for military personnel on active duty and their dependents. We believe adoption of that recommendation would be manifestly unfair to retirees, widows, and totally disabled veterans. Many of these people made their decision to remain in uniform with the expectation that tax-free exchange and commissary privileges would continue. Many paid a real price for their uniformed service or that of their dependents. Many selected their retirement homes based on their proximity to military installations. To eliminate the tax-free exemption for them will be perceived as a breach of faith.

The report makes no reference to the possibility that if the *Buck Act* is amended this may well have an impact on our uniformed men and women stationed overseas. We have commissaries and exchanges overseas. Those foreign countries where these resale facilities are located have, by formal agreement or otherwise, exempted from import duties merchandise entering the country for resale in exchanges and commissary stores. Action to permit domestic sales to be taxed could cause these countries to review their tax exemptions for the U.S. military with a view toward eliminating all or a part of the exemption.

The report makes frequent reference to “bootlegging” by patrons of military resale outlets particularly with regard to cigarettes. This accusation is supported primarily by statistics which purport to show that in states with a high sales tax on cigarettes per capita consumption is higher among military store patrons than among civilian store patrons. The conclusion is then drawn that this higher per capita consumption is due to “bootlegging” by military store patrons.

We have two serious doubts about the validity of the statistics contained in the report.

First, the data on civilian store sales was collected by the National Tobacco Tax Association which relates only to the sale of taxed cigarettes. According to a statement by the president of the Eastern Seaboard Interstate Cigarette Tax Enforcement Group, as reported by the *Washington Post*, \$400 million in cigarette taxes go unpaid in its 11 member states because of “bootlegging” from low-tax to high-tax states. The executive manager of the Wholesale Tobacco Distributors of New York estimates that one out of four packs of cigarettes sold at retail in New York State and one out of two in New York City are “bootlegged” or “highjacked.”

Second, the report estimates the military store patron population aged 18 and over by increasing by 3.6 percent the estimated number of active duty and retired personnel and dependents. The 3.6 percent was, according to the report, based on a survey of commissary store patrons by Army Air Force Exchange Service personnel. We have found no one at the headquarters of the Exchange Service who could confirm the accuracy or usage of that percentage. We strongly suspect that 3.6 percent is low in view of the fact that there are sizable populations of eligible purchasers other than active and retired

members and dependents. These groups include 950,000 members of the Selected Reserve, 125,000 totally disabled veterans and dependents, and a sizable number of widows of active and retired personnel and their dependents.

We have taken and shall continue to take stringent steps to deal with any improper military cigarette sales. In this connection, I might add that in my judgment, military contracts provide an element of professional risk which acts as a deterrent to bootlegging and which is not present in the normal mechanisms to deal with this problem in the private sector.

The Department of Defense does not, however, believe that the data cited in the report supports the prominent and repetitious reference to alleged "bootlegging" as a very germane factor in your deliberations on state and local taxes on military store sales, and in my opinion introduces an unwarranted bias in this situation.

Mr. Chairman, this concludes my statement. We will try to answer your questions at this time.

Information Concerning State Income Tax Liability

The following publications are examples of the information 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 used 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 5840.6F, "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 non-appropriated 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 worldwide to 80,000 military commanders and their key staff officers. Volume 17 was devoted entirely to state income taxes.

Statement of
Colonel F. Meyer, Jr., U.S. Army, Retired
Legislative Counsel, The Retired Officers Association

I am Colonel F. Meyer, Jr., U.S. Army, retired, legislative counsel for the Retired Officers Association, which has a membership of over 220,000 retired, former, and active duty officers of the seven uniformed services. I also represent the Retired Enlisted Association, REA, whose headquarters is in Colorado Springs, Colorado.

I appreciate the opportunity of appearing before this Commission to express our views on your report entitled "Differential State and Local Taxation of Military Personnel: An Intergovernmental Problem."

My remarks are directed solely to the chapter in the report that deals with sales and excise taxation of on-base sales to military personnel.

Our associations are unalterably opposed to any proposal that would require military personnel who make purchases at military exchanges and post and base commissaries to pay state and local sales and excise taxes.

In other words, we concur wholeheartedly with the recommendation which would retain the current tax exemption on sales to all military personnel.

We do not agree with any recommendation which would allow states to impose cigarette and tobacco taxes on military store sales of these items, any recommendation which would terminate the present tax exemption for military retirees, or any recommendation which would remove the exemption for all military personnel, active and retired.

Our immediate concern about removing the current tax exemption is for the older retiree, the individual whose retirement is based on pay scales in existence before the recent series of active duty pay increases which were designed to achieve comparability with civil service and civilian pay.

Many in this group are at or approaching an unemployable age and do not have the full advantage of Social Security Insurance. Depressed pay scales during their active service allowed little or no opportunity to accumulate savings or equity in a home.

About two-thirds are enlisted. As a matter of fact, among the one million retirees there are more E-7's, Sergeants First Class, than officers in all grades. Senior officers make up only a small percentage, with a fraction of 1 percent being in the grade of general.

Department of Defense figures indicate that almost half of the military retiree group receive a retirement income below \$4,000 annually.

Unfortunately, they are sometimes forced to seek public assistance. Commissary managers report that this group accounts for a sizable share of the \$1.5 million in food stamps being redeemed monthly at their checkout counters. Though the majority of retirees try to settle near military installations, due to base closures and other factors, many must shop in commercial groceries, making it impossible to obtain complete food stamp figures.

At the other end of the military spectrum is another group for whom the tax exemption may be the difference between survival and a marginal existence. This group is made up of junior members of the active force, officers, and enlisted men in the lower grades—in the first ten years of their military careers—with young, growing families.

It is this group that accounts for the balance of food stamps being redeemed in the commissary. As in the case of the retirees, more than two-thirds of the active force is enlisted.

However, there is a greater proportion at lower pay grades. The greatest share of enlisted people are in the grade of E-5, or below, and receive less than \$8,000 a year in pay and allowances. Most marry in their first five years of service, and children arrive soon thereafter. Particularly in peacetime, promotions rarely keep pace with increased financial responsibilities.

Thus, the savings realized by the tax exemption are a very real and necessary economic fact of life.

In particularly citing the people at the extreme of the military spectrum, I do not intend to denigrate the significance of the tax exemption for the rest of those who are entitled to it, including the balance of the active force and the retirees, the 125,000 totally disabled, holders of the Medal of Honor and their dependents and survivors. Though most of us are better off than the older retirees and the younger members of the active force, no one ever selected a military career to acquire wealth.

This brings me to a final observation. The report, in effect, states that the rationale for exempting post exchange and commissary sales from state and local taxation is withering away because military pay has been increased substantially.

I hasten to acknowledge that the increase in regular military compensation and other benefits of recent years have improved appreciably. As a result, most of those in uniform today are no longer in the precarious financial state of their predecessors. However, the older retiree, whose plight I have just discussed, has not benefited from such increase.

One other point. Because of the nature of the profession, military compensation can never be represented adequately in dollars and cents.

The greatly misunderstood fringe benefits, commissaries, post exchanges, exemption from state and local taxation of on-base sales, medical care and space available travel, all have a symbolic significance that overrides their dollar value many times. Their continuation represents a symbolic expression of national appreciation for the sacrifices that almost every military person has been called upon to make sometime in his career. There is no substitute for them.

It would appear that the effort to reduce or eliminate military fringe benefits is being pursued on an orchestrated basis by civilian managers who have no long-term responsibility for their actions.

When the results of their misjudgments are known, they will have long since returned to other pursuits. Defense Department leaders have recommended to Congress that the commissaries be gutted. Congressional hearings have already been held on this matter. The Department of Health, Education and Welfare and the Office of Management and Budget have joined with the Department of Defense in an interagency study which is apparently designed to reduce the military health care system to the capability of an aid station.

In conclusion, I want to underscore a point that should be self-evident to this group. For some strange reason there has always been foisted upon the public at large the contention that military persons—active and retired—are not taxpayers.

Being by profession an attorney, and based on my intimate association for over 30 years with professional personnel of both officer and enlisted grades, I can attest that as a group, military personnel are among the most faithful and straightforward in meeting their tax obligations. I believe based not only on the type of morality military service engenders but also because those individuals have a higher appreciation of the purpose to which their tax dollars are devoted.

Nonetheless, we fight this issue on yet another point of integrity. Over the years, military personnel have suffered low pay and other privations based on the certain knowledge that their fringe benefits, which somewhat offset inadequate compensation, were an entitlement that would continue into retirement. For that reason we are most disappointed that the Commission's staff would give more than passing consideration to proposals which would be, in effect, a breach of faith with those who had long and honorably served their nation.

In consideration of the foregoing, it is strongly recommended that the current state and local exemption of on-base sales granted military personnel be continued.

Thank you very much.

Statement of
Robert Fitzgerald

Legislative Counsel, The National Association for Uniformed Services

I am Robert R. Fitzgerald, legislative counsel for the National Association for Uniformed Services. We thank you for providing us the opportunity to appear before you today, to discuss two items of utmost importance to our members of the uniformed services. These are the proposed state sales tax on commissary and post-base exchange purchases and the state-local taxation of military pay.

It appears as though a well coordinated effort is being made to reduce many benefits and entitlements that the military community has been promised and earned over the years.

Within the past year, the Office of the Secretary of Defense has made policy changes to sharply reduce many of the attractive benefits which have encouraged personnel to seek a service life, for example, reduction in medical benefits; change in the method of allocation of pay increases; suspension of automatic reenlistment bonuses and reenlistment travel payments; curtailment of lump sum unused leave payments; and sharp reduction of degree training programs, to name a few.

A move is being made to reduce commissary savings. Veterans' benefits are stopped for personnel currently entering the services. Elimination of the 1 percent cost of living ad-on increase to keep up with rising inflation for retirees is being entertained.

The House Ways and Means Committee held hearings this past July to consider reduction in the sick pay exclusion entitlement and taxing the disability retired pay of retirees.

We understand the bill is now being marked up to reduce or eliminate sick pay exclusions, the disability retired pay, and possibly the Veterans' Administration disability compensation.

As we sit here today, the Administration is recommending the active military be given a 5 percent increase while the inflation rate increases at about 12 percent.

There are to be hearings on changing the current military retirement system which in all probability will result in less pay for those retiring in the future.

We also must consider the current pay inversion now occurring because of recent rulings made by the Comptroller General. Now this commission is considering proposals to place sales tax on the purchases made in commissaries and exchanges. It is erosion here, nibbling away there, and more earned entitlements and benefits going down the drain.

As Kipling said: "For it's Tommy this, and Tommy that, and chuck him out, the brute. But it's savor of 'is country, when the guns begin to shoot."

It is the erosion of these benefits coupled with inflation that is causing many in the military community to become concerned today.

As the ACIR report points out, and correctly so, "The right of military persons to make commissary and PX purchases free of all state and local sales and excise taxes is a tangible benefit long held and rightly valued by these groups."

The thought that tax relief is provided when a wartime environment exists and then taken away afterwards seems inequitable to us. Tax relief is one of the methods of providing for the many sacrifices made by those pursuing a military career.

The report makes a point that changes in general military lifestyle and substantial increases in military pay—along with the advent of the all-volunteer armed force—have undercut the rationale for the military store tax exemption.

This may be true to some degree within the past year or so. Also, it is much too early to judge the results of the all-volunteer armed force. It will require more time to make a full evaluation.

The above alludes to the so-called comparability theory. There is hardly any comparison that can be made in job comparability or pay comparability between the military and private sectors of our economy. If we try to make a comparison, it is readily apparent that the risks alone in what we expect of members of our military establishment cannot be compensated fully. When we consider other factors

such as working hours, separation from families, frequent transfers, etc., there just is not enough in the military budget to compensate fully any military force. The methods used by the private sector to equate hours and work performed in relation to compensation provided employees just cannot be applied in the same manner to the military. Thus, we support a position of *status quo* with regard to state and local sales and excise taxes on purchases at military stores.

In the area of state-local taxation of military pay, we recognize that the matter is quite involved and complex. However, in reviewing the information and recommendations, we support the recommendation which would preserve the *status quo*.

The second part of the state-local taxation is an area we believe can be more fully addressed by the Department of Defense.

Mr. Chairman, and members of the Commission, on behalf of our members, we thank you for letting us contribute our thoughts here today. I will be pleased to answer any questions.

Statement of
C. A. "Mack" McKinney

Director of Legislative Affairs, Non Commissioned Officers Association

I am C. A. "Mack" McKinney, director of legislative affairs for the Non Commissioned Officers Association of the U.S.A. (NCOA) and a retired sergeant major of the Marines. I enlisted in the Marine Corps in 1942 and retired in 1971.

The NCO Association is the largest enlisted military organization of its kind. Its membership is composed of non-commissioned and petty officers of the U.S. Armed Forces. More than 80 percent of the members are presently on active duty with the Army, Navy, Marine Corps, Air Force, and Coast Guard. Truly then, the NCOA, having a membership in excess of 150,000, is representative of the major element of the military forces—the enlisted men and women who comprise 86 percent of some 2.1 million members serving their nation today.

The issues before the Commission, whether or not to amend the *Buck Act* and/or the *Soldiers' and Sailors' Civil Relief Act*, are vitally important to our membership and to all members of the Armed Forces.

Frankly, and in their behalf, the NCOA favors the *status quo* recommendations suggested in the study, *Differential State and Local Taxation of Military Personnel: An Intergovernmental Problem*. Our position therefore is relatively simple: the *Buck Act* and the *Soldiers' and Sailors' Civil Relief Act* should remain exactly as they read at the present. We cannot rationalize any changes at this time.

Please allow me to assure the Commission that the NCOA is neither obstinate nor tenacious in holding to this opinion—despite the fact that the military community has been the economic scapegoat of the Department of Defense, the Administration, Congress, and others ever since the Vietnam conflict ended for all practical purposes.

The U.S. Army recently noted that some 50 benefits and programs for its soldiers have been eliminated or reduced. Many we can identify. There are others presently under proposed change by the Department of Defense, as submitted to Congress,¹ and now we are faced here with additional attacks by state and local governments in an effort to increase their revenues.

The question is simply this: "When or where does it all stop?"

Is it so easy to forget that the military forces are the protectors of this great nation? That they are subject to many inconveniences and sacrifices above and beyond that realized by our civilian brethren?² Have we dismissed the valiant efforts of the servicemen who participated—some of them never to return—in the evacuations of Cambodia and Vietnam, or in the recovery of the U.S.S. Mayaguez? And can we turn our heads to ignore the fact that in the last 30 years, as an example, our military forces have been flung across the width and breadth of our world with only one—I repeat—one year free of any conflict or threat of hostility?³

Rudyard Kipling said it well.⁴ Once the fighting is over, very few citizens appreciate the military. Many look upon them as a necessary evil, and today—because of certain publicity, much of it released by or as a result of the Department of Defense—believe that military members never had it so good.

Notwithstanding this era of economic hostility against the military, the NCOA does not harbor ill feelings against the general public. They are only misinformed by certain governmental agencies and public officials who proclaim that the military is now receiving "comparable" pay and that the military retirement system is one of the most generous in the world.

Basically and generally, these two arbitrary suggestions have been the premise on which Congress has eliminated or reduced certain pay, allowances, benefits, and programs for the military, and on which certain state and local governments now are seeking additional revenues from military personnel.

It is the purpose of the NCOA to discredit these claims, and to prove that today's military—although much better off than their predecessors—are not so richly endowed as most Americans are led to believe.⁵

The final recommendation of this distinguished Commission will have the greatest impact on enlisted military personnel. As noted earlier, their strength is about 86 percent of the total active duty force. Of some 2.1 million members, enlisted personnel comprise 1.95 million of that figure. The largest majority is within paygrades E-6 and below at 77.6 percent of the total force, or 1,765,029 individuals.⁶

In 1973, this group (E-6 and below) earned an average of \$136.26 a week, or \$7,085 in total Regular Military Compensation.⁷ In comparing their earnings with those of civilian non-supervisory workers, there was a difference of 25.5 percent in favor of the civilians.⁸

In yet another example, we note that 66.9 percent of the total military force are enlisted members in paygrades E-5 and below, and that over 50 percent are in paygrades E-4 and below. Their average compensation is even less than that for E-6 and below.⁹

The average paygrade of the military is an enlisted E-5, and the average paygrade of the enlisted force is an E-4. The average E-4 earns approximately \$121 per week as opposed to \$171 for civilian non-supervisory workers in non-manufacturing industries—a 41.3 percent difference.⁹

However, the earning figures offered above for enlisted personnel are generous almost to a fault. Only 44 percent of the total enlisted force receive cash allowances for living in the civilian community.¹⁰ Of the total force (officers and enlisted) the percentage is 47 percent.¹¹

It has been suggested by the Department of Defense that fringe benefits account for 25 percent of the military members' total compensation.¹² But most of that percentage is based on a career of 20 or more years of active service. Unlike commissioned officers who have a "vested" interest in a retirement system after serving a maximum of five years, regular enlisted members must serve a minimum of 20 years to be entitled to retirement benefits.¹³ And it is noteworthy to mention here that only 10 to 11 percent of the total military remain on active duty long enough to receive retirement pay.¹⁴

In connection with retired pay, it should be noted that over two-thirds of the number of retired military persons are enlisted members. Their average pay is less than \$340 a month.¹⁵

But regardless of the amount of retired pay, the majority of military retirees contribute much more to state and local treasuries than the majority of retired civilians.¹⁶

For example, a military member retires and settles in the State of Virginia.¹⁷ He has never been domiciled or stationed in that state prior to his retirement. He is employed in a civilian occupation and his annual income consists of \$7,950 in retired military pay and \$16,600 in civilian wages. He has two dependents.

Based on total income (for 1974) his state taxes amounted to \$971. However, if he were responsible to the state for only a personal income tax computed on his civilian pay alone, the retiree would have paid only \$483. **By adding his retired pay to his income—pay that he did not actually earn as a result of being a resident of Virginia—that state realized more than double the amount it would have received otherwise.**

Not only this, but because of the retired pay involved, the Federal government is in receipt of \$2,126 more than it would have received if the member was not a retired military person. Under the personal income tax levy, our retiree might have paid only \$2,340 on his civilian pay instead of \$4,466.

In dealing with military pay (or compensation) versus civilian pay, the ACIR report contributed just a bit less than two pages to the subject. It noted that average regular military compensation had increased 100 percent between 1964 and 1973, and that basic military pay had risen 125 percent.

But do percentages really tell the true story?

For example, during the period 1950 to 1972, farm workers' annual earnings rose 190.1 percent, Federal employees' earnings increased by 187.1 percent, railroad employees by 160.8 percent (up thru 1970), industrial workers by 162.6 percent, and military personnel by 161 percent. Therefore, we could on the basis of the text of the report assume that farm workers draw more money than the other groups mentioned. However, the real story lies in the dollar amounts. Although the farm workers' average annual earnings went from \$1,452 to \$4,212, they probably remain the lowest paid workers in the United States.

Who is next to the bottom? The average military enlisted member who went from \$1,473 in current dollars in 1952 to \$4,661 in 1972.

And on one final note, let us not forget that prior to the 1950's our military personnel had no deductions from their pay and allowances. Although they realized but a small increase in pay between 1949 and 1958,¹⁸ the Federal government imposed Social Security and personal income taxes on the military in the 1950's. In the 1960's, in particular, many military personnel were subjected to state and local taxes. So what may have been gained in pay increases was lost to new Federal and state tax obligations.¹⁹

In summary, the NCOA petitions the Commission to accept the *status quo* on the *Buck Act* and the *Soldiers' and Sailors' Civil Relief Act* and to recommend such to the Congress of these United States because:

—Our military personnel, particularly enlisted members, have suffered sufficient monetary losses over the past two to three years. So have military retirees.

—Regular enlisted personnel, comprising 86 percent of our military forces, must serve a minimum of 20 years before they have a vested interest in their retirement system.

—In most states having personal income taxes and not exempting military retired pay, military retirees will pay additional taxes to the state and local governments on income (retired pay) that may not have been earned (fully or partially) as a result of either living or being stationed in that state.

—Regular enlisted personnel stationed in Germany will pay two to four times more for auto insurance than they would pay in the United States.

—Commissary and exchange sales at lower prices and certain tax-free benefits have been incentives for many persons to enlist or reenlist in the military. Since only 10 to 11 percent of the total force remain in service long enough to take advantage of the many fringe benefits offered by the military forces, further reductions or terminations of these benefits may very well jeopardize the eventual success of the all-volunteer force.

And speaking briefly on the all-volunteer force, it is foolish and completely naive to say it is a success at this time. We must wait until the unemployment figures drop to normal before the concept can be adjudicated.

On behalf of the association, I extend sincere appreciation to the Commission for allowing its representative to appear before you. If I may, I would like to leave you with these words of President Theodore Roosevelt:

"No other citizen deserves so well of the Republic as the veteran. They did the one deed, if left undone, would have meant that all else in history went for nothing. But for their steadfast promise, all our annals would be meaningless, and our great experience in popular freedom and self-government would be a gloomy failure."

Our military has served the nation well. We, its citizens, should serve them equally as well.

Thank you.

FOOTNOTES

¹ See Annex A (NCO Association's Position Paper on "Military Commissaries"—released in early 1975).

² See Annex B (A partial list of inconveniences normally attributed to military life).

³ 1973 World Almanac and Congressional Record for July 20, 1973.

⁴ A poem, "Tommy," by Rudyard Kipling.

['O making' mock o' uniforms
that guard you while you sleep,
Is cheaper than them uniforms,
an' they're starvation cheap;
An hustlin' drunken sodgers when
they're goin' large a bit,
Is five times better business than
paradin' in full kit.
Then it's Tommy this, an' Tommy that,
an' 'Tommy 'ow's yer soul?'
But it's 'Thin red line of 'eroes
when the drums began to roll.'']

⁵ Senate hearings before the Committee on Appropriations, Department of Defense Appropriations, 93rd Congress, Second Session, Fiscal Year 1975, Part 1, DoD, Defense Agencies, and Public Witnesses. Defense Secretary Schlesinger (in answer to a

question by Senator Fong): "As a general proposition, Senator Fong, the regular military compensation has risen dramatically in recent years, but most of that increase in military compensation is due to the fact that over a period roughly from the Korean War to the middle 1960's the lower grade military personnel received no increases in their basic pay. If one considers all sectors of the economy, going back to 1950, **military compensation which has risen dramatically since the middle 1960's still has not risen as much as other sectors of our economy have.**"

6 See Annex C (NCO Association's Position Paper on "Civilian-Military Pay Comparability").

7 Regular Military Compensation (RMC) is the amount of basic pay plus quarters and subsistence allowances (BAQ) (BAS), and tax advantage.

8 See Annex C, p. 8.

9 *Ibid.*, p. 7.

10 *Ibid.*, p. 11.

11 "Comparison of the percent of the force (FY 1974) residing in civilian communities and in government quarters by pay grade" (DoD Chart).

12 An article by John Finney, from the *New York Times*, as published in the *Washington Star News*, Monday, March 10, 1975, in John Cramer's "9 to 4:30" column.

13 Title 10, *United States Code*.

14 Based on Department of Defense estimate.

15 As of June 30, 1974, there were 671,247 enlisted retirees as opposed to 318,587 officers. Average retired pay for enlisted retirees was \$339 per month.

16 Of the 50 states and the District of Columbia, ten have no income taxes; seven exempt all military retired pay, 27 exempt military disability retired pay affecting only about 16 percent of total retirees; and all others (34) have partial or no exemptions.

17 As of June 30, 1974, Virginia had 53,480 military retirees living within its state boundary.

18 Monthly military pay for privates (now paygrade E-1) rose from \$75 to \$78. For master sergeants (now paygrade E-7) basic pay increased from \$198 (low) and \$294 (high) to \$206 and \$350.

19 Additionally, enlisted personnel entitled to subsistence allowances in 1952 through 1958 saw this allowance decreased \$14.88 per month (from \$47.88 in 1952 to \$33.00 in 1958).

Annex A

NCO Association Position Paper on Military Commissaries

For the past two years, concentrated attacks on military compensation and benefits have been prevalent in the Nation's Capital. Administration and Congressional actions have reduced or completely impaired certain entitlements promised to military personnel under previous law or by former defense policies. Others are under scrutiny and targeted for action in 1975.

A review of the past, notes the following areas affected by policy alterations or changes in law:

- Orthodontia treatment, special and remedial education services, and psychotherapeutic care, all under the CHAMPUS program, drastically reduced, terminated, or restricted.
- CHAMPUS fundings reduced.
- Health care at military installations dramatically reduced or terminated for military retirees and their dependents, and for survivors of military personnel.
- Automatic reenlistment bonuses terminated.
- Reenlistment travel payments stopped.
- Comparable overseas housing assignments (with civil service employees) revoked.
- Unused leave payments curtailed.
- Degree training programs for enlisted personnel stopped.
- USAFI disestablished.
- Compulsory contributions to Soldiers' and Airmen's Home increased.
- Promotion to E4 and E5 in U.S. Army delayed.
- Future pay increases diluted (and Social Security contributions increased).
- Future retired pay annuities reduced.
- Enlisted personnel denied reenlistment under the guise of qualitative management without separation pay.
- Proficiency and special pay for thousands reduced and to be terminated during FY 1976 (although lack of funds caused many earlier cutoffs).

- Comparable benefits, enacted into law for civil service and Federal employees, lagging for the military.

All this and yet others of minor importance transpired while inflation ate away another 8 percent of the purchasing power of the military family dollar. But we may not have seen anything compared with what can be in store for the military community during the 94th Congress. Federal administrators and legislators will be looking at the new proposed *Uniformed Services Retirement Modernization Act*, a proposal by the President of the U.S. to hold future pay and annuity raises to a 5 percent maximum (regardless of inflationary increases in costs of living), and an Administration plan to make all military commissaries self-supporting by October 1977.

The latter has brought on many protests from the military community. Whereas former actions may have affected only segments of the community, the commissary issue touches almost every member of the active duty forces and their dependents, military retirees and their dependents, survivors of deceased military, 100 percent service-connected disabled veterans and their dependents, and all Medal of Honor winners, who are entitled to commissary privileges.

Annex B

Excerpts from a statement by C. A. "Mack" McKinney, director of legislative affairs, NCO Association, on H.R. 15406 before the Subcommittee on Manpower and Personnel, Committee on Armed Forces, U.S. Senate, Second Session, 93rd Congress

Let's take a look at the following list of inconveniences normally attributed to military life. How many Federal workers are subjected to the same conditions?

- Frequent transfers.
- Participation in combat, or assignments in areas of hostility or probable hostility.
- Long and frequent separations from families.
- Double-jeopardy under law (military and civilian).
- Difficulties in establishing permanent home for self and family.
- Lack of tenure of service protection for enlisted members (can be discharged or released from duty at will of Service), and no provisions of law for severance or readjustment pay.
- Frequent overtime commitments without compensation (i.e.—field exercises, inspections, alerts, extra duties, etc.).
- Forced feeding in military mess halls for majority of enlisted personnel.
- Forced occupancy of military quarters (many of World War II vintage) or housing (many inadequate and substandard).
- Loss of quarters and subsistence allowances-in-cash when required to reside or eat aboard military installation.
- Forced payments of high auto-insurance premiums, particularly for enlisted personnel in overseas areas such as Germany.
- Unstable, and frequent changes in qualifications for promotions to higher grades (primarily affecting enlisted personnel).
- Overseas assignments without transfer of household effects (limited to 2,100 lbs. for enlisted personnel).
- Forced retirements, particularly for enlisted members at less than 30 years, normally at 21 years, requiring urgent plans and preparations for second careers and future residences.
- Assignments to high-cost areas in U.S. without increases in cost-of-living or housing allowances, and where sufficient government quarters are not available. (For example, over 45,000 enlisted personnel are assigned to the Washington, D.C., area where only 4,500 government housing units are available for married members.)

—Assignments to independent-type duties away from military installations with entitlement to the same subsistence allowance that was paid to enlisted personnel back in 1962.

Many others could be added to the preceding, however, time nor space permits a complete listing. But on the basis of the items noted, it is obvious that no comparison can truthfully weigh military compensation with that received in the civilian sector.

Annex C

NCO Association Position Paper on Civilian-Military Pay “Comparability”

Much has been written and spoken on civilian and military pay comparability. But for proponents or opponents of “comparability,” substantiating data is difficult to obtain. Others suggest that comparing the two is about the same as weighing the value of apples against oranges. It is not, however, quite that simple.

Webster’s New World Dictionary (of the American Language, Second College Edition) defines the word “comparable” as: “(1) that can be compared; having characteristics in common, (2) worthy of comparison.”

Apples and oranges therefore may be worthy of comparison for both are fruit. On the other hand, civilian pay and military pay can be comparable only if one considers that there is but one *common* characteristic—the exchange of currency for services rendered.

Unfortunately, most proponents choose to compare civilian pay (the amount of actual wages received) with military “compensation” (the amount of pay, allowances, benefits, and other direct and indirect remunerations). This immediately loses that one common characteristic and places a much greater emphasis on the value of military pay.

For example, military pay for them is never the actual cash received. It is either a combination of:

1. **RMC** (Regular Military Compensation): The amount of basic pay plus quarters and subsistence allowances plus tax advantages, or
2. **Total Manpower Appropriation**: RMC plus special allowances and bonuses plus the value of fringe benefits plus family housing and commissary construction costs.

All military members receive basic pay, but that is as far as equity goes. In 1974, only 47 percent (44 percent of enlisted) received cash for quarters allowances, and 62 percent received cash for subsistence (food) allowances. Only 62 percent therefore receive a tax advantage of sort. The remainder live in government (military) housing or quarters and receive subsistence in kind (are fed in military dining facilities).

Again in 1974, less than one-half of all military members received special allowances and bonuses and about that many took advantage of commissary privileges. Probably the only “fringe benefit” exercised by the majority may have been exchange privileges and reduced theater costs. As for retirement benefits, reported as part of the compensation picture, only 10 percent of the total input into the Armed Services remain on active duty long enough to draw retirement annuities.

As it is with their military counterparts, all civilian workers receive cash for services rendered. Additionally, some receive room and board, and some receive cash allowances or expenses for housing and/or meals. Many receive bonuses and/or special allowances while others receive discounts on items purchased from their employers. For those who purchase their own homes (a “privilege” denied most military members because of their involuntary nomadic existence) there are tax advantages. For other employees there are no-cost retirement funds, free medical care on-the-job, discounts for meals purchased on the employer’s premises, commissary stores, and so on.

Finding a true gauge to compare military pay with that of the civilian sector is almost an impossible task. For the most part, military personnel are subject to many inconveniences and sacrifices normally not attributable to civilian wage earners. There are separations of long duration from family and friends, overtime work without cash remuneration, transfers every three to five years, long months in hostile areas, and the possibility of death (or being maimed for life) at the hands of the enemy. And for all, they are subject to both military and civilian laws, are constantly on alert for contingencies and

emergencies, and are under contract to the Federal government without like guaranty of any sort. (For example, all regular enlisted personnel are not protected by law [or contract] while on active duty.)

Thus there can be no comparability unless one compares the amounts of actual currency received by the two factions. Otherwise, there are too many dissimilarities—all tending to confuse anyone who attempts “comparability.”

For the past two years, the military has been the recipient of erosions in pay, allowances, and benefits. Others loom on the immediate horizon. Threats have been made to military commissaries, future military pay increases, the military retirement system, and unused leave payments—all of this under the guise of civilian-military “comparability.”

Recently, the Secretary of Defense told his Service secretaries that he is fed up with complaints about erosions. He blamed inflation as the main cause of the problem, but did cite the usual department’s rationale that, “regular military compensation has increased 87 percent since 1967 while civil service salaries increased 65 percent,” and “military pay is competitive with that of the civilian sector.”

Additionally, there extends another school of thought that has been repeated constantly: “military pay is consuming nearly 55 percent of the defense budget.” Coupled with “comparability,” both the Department of Defense and opponents of the defense budget are out to further reduce the pay, allowances, and benefits of military personnel.

Both intellections are of course ambiguous and may very well border on complete falsity. It will be the purpose of this “paper” not only to provide the necessary facts to disclaim comparability of military pay to that of most of the civilian sector, but to prove that, if anything, military pay may have lost ground with civilian pay over the past 20 to 25 years.

Percentage of Budget

Prior to Fiscal Year 1973, the Department of Defense budget proposals listed both military pay and allowances and DoD civilian employees’ pay as separate items. During the past two fiscal years, the budget has reflected only military pay and allowances as a separate item. Civilian employees’ pay was included, and well hidden from the general public in operations and maintenance costs.

Nevertheless, when referring to military manpower appropriations, both payrolls were “lumped” together as a single entity. For example, the 1975 budget included \$22 billion for active duty military pay and allowances and \$14 billion for civilian pay. In addition, defense also included costs for its reserve and National Guard units, for its family housing, and for retired military pay annuities. Together the five programs totaled nearly \$48 billion. With an approved defense appropriation in excess of \$87 billion, “military manpower costs,” as defined by DoD, consumed nearly 55 percent of the budget.

But in reality, active duty military pay and allowances were less than 26 percent of the total defense appropriation.

Mixed with other programs, less the civilian payroll, the percentages look something like this:

(In billions of dollars)

Active Duty Pay and Allowance	Guard and Reserve	Family Housing	Retired Pay	Percent of Budget
\$22.1	\$4.8			30.9
\$22.1		\$1.1		26.7
\$22.1			\$6.0	32.3
\$22.1	\$4.8	\$1.1		32.2
\$22.1	\$4.8		\$6.0	37.8
\$22.1		\$1.1	\$6.0	33.6
\$22.1	\$4.8	\$1.1	\$6.0	39.1

In all cases, military pay and allowances were less than 40 percent of the defense budget. Compared to other governmental agencies’ budgets, as well as those of most civilian businesses, actual military manpower costs were disproportionately less.

Comparable or Competitive

Depending upon who is the spokesman for the Department of Defense, military pay is either "comparable" or "competitive" to civilian pay. The former has been defined in this "paper" and adequately debated; yet there are additional facts that further disclaim "equity" of one pay system to the other.

Military pay (actual cash received) is based on any number of odd factors; i.e., whether living on or off of a military installation, whether single or married or married with dependent children, whether food services are furnished or not, whether in a technical or non-technical occupation, whether the occupation is hazardous or not, and so on. On the other hand, civilian pay is normally set at a gross level based on the economy and rarely considers the factors related to military pay and allowances. In determining gross pay for civilians, local costs of food, clothing, shelter, medical care, etc., are and must be considered.

The military, however, relates certain payments on worldwide or nationwide averages. For example, food allowances are based on the actual costs of feeding an average member in its worldwide installations. In 1974, it was \$2.28 per day, or \$68.40 each month. This was considerably less than civilian costs. Should the military raise its food allowances to coincide with that of the civilian economy, the Federal government would realize further costs in excess of millions of dollars daily.

Military pay (actual cash received) is based on any number of odd factors; i.e., whether living on or off of a military installation, whether single or married or married with dependent children, whether food services are furnished or not, whether in a technical or non-technical occupation, whether the occupation is hazardous or not, and so on. On the other hand, civilian pay is normally set at a gross level based on the economy and rarely considers the factors related to military pay and allowances. In determining gross pay for civilians, local costs of food, clothing, shelter, medical care, etc., are and must be considered.

The military, however, relates certain payments on worldwide or nationwide averages. For example, food allowances are based on the actual costs of feeding an average member in its worldwide installations. In 1974, it was \$2.28 per day, or \$68.40 each month. This was considerably less than civilian costs. Should the military raise its food allowances to coincide with that of the civilian economy, the Federal government would realize further costs in excess of millions of dollars daily.

Military housing allowances are another area of non-comparability. In 1974, sessions with Congressional Committees on Armed Services, the Department of Defense admitted the allowance was "significantly lower than the median housing expenses reported by the Federal Housing Authority." Here again, the Federal government would have further increases amounting to hundreds of millions of dollars each year if it provided the median expenses for housing.

In 1974, almost 86 percent or 1.9 million members of the Armed Services were enlisted personnel. Of that total, 1,065,503 were living on base. If they were to receive housing allowances in cash in lieu of on-base quarters, the costs to the government would be an estimated \$1.4 billion or more each year (in 1974 dollars). This is almost double the appropriation request for family housing (\$771 million) that same year.

Probably the nearest civilian occupation to military service is that of policemen or firemen. Like their military brothers, death or maiming is a constant threat. Yet there still remains that big difference. Civilian policemen and firemen are not subjected to the same inconveniences and sacrifices demanded of the individual military member.

Anyway the picture is turned, whether it is a "doctor, lawyer, or Indian chief," there is simply no comparison of military and civilian pay.

"Competitive" pay is a similar story.

In *Webster's New World Dictionary* (of the American language, Second College Edition), the word is defined as: "of, involving, or based on competition" [(1) the act of competing; rivalry (2) a contest, or match (3) official participation in organized sport (4) opposition, or effective opposition, in a contest or match (5) rivalry in business, as for customers or markets (6) the person or persons against whom one competes].

Of the six noted, number 5 may be the only definition suitable for competing military pay against civilian pay. As such, it is assumed that the Department of Defense utilizes the word in connection with

its personnel procurement program. Its use, however, may be good or bad depending upon whoever is supporting or opposing the quality and quantity input of recruits since the all-volunteer force came into its own. In 1973 and early 1974, there was some question as to both, but since then one could say military pay is "competitive" during this period of soaring unemployment. Anything, of course, is better than nothing.

But if facts and figures are of consequence, average military pay was not competitive to civilian pay some years ago—and is not competitive today.

In researching data for this "paper" all figures for 1974 were not readily available. Earlier years had to be used. In any case, it is a known fact that military pay (compensation) underwent a number of significant changes particularly in 1974 while civilian pay (and benefits) for the most were increased.

For the majority of military members, some 80 percent, many special allowances were reduced or completely deleted (i.e., automatic reenlistment bonuses, reenlistment travel payments, performance and specialty pay, and unused leave payments).

Additionally, Congress passed a new "3-Way Split" bill reducing amounts of future pay increases for military personnel. The vast majority of military members "lost" increases amounting to \$5 or more per month. For example, a member drawing \$600 in basic pay, \$150 in quarters allowance, and \$70 in subsistence (food) allowance realized an approximate pay increase of \$43. If the increase had been applied under the previous law, the amount would have been nearer \$49.

From what has been presented in the preceding pages, and considering the definitions of the two words, military pay is neither "comparable" (having a common characteristic) nor "competitive" (matching equal or near equal factors) with civilian wages. To further prove the point, the next chapter will deal strictly with facts and figures obtained from outside sources.

Facts

One fact is significantly important to repeat again: "Almost 86 percent of the total Armed Services are enlisted personnel" (paygrades E-9—E-1). Other percentages are as follows:

TOTAL OFFICERS	14 percent
(TOTAL ENLISTED — Paygrade E-9)	0.75 percent
(TOTAL ENLISTED — Paygrade E-8)	2 percent
(TOTAL ENLISTED — Paygrade E-7)	6 percent
(TOTAL ENLISTED — Paygrades E-6 and below)	77.6 percent
(TOTAL ENLISTED — Paygrades E-5 and below)	67 percent

(NOTE: Military cadets are not included.)

Of the total force the average military member is in paygrade E-5. Of the total enlisted force it is paygrade E-4.

In 1973, the average E-4 drew an estimated wage of \$6,284 in pay and allowances. This works out to \$523 per month, \$121 per week, or \$3.03 an hour for a 40-hour workweek. **If the E-4 had a lower income, and many did, and had also a wife and two children, he may have been eligible for food stamps. (In November 1974, military commissaries redeemed \$1,367,592 worth of stamps—almost double the average for the previous 12 months.)**

In reviewing the 1973 earnings of civilian maintenance, custodial, and material movement workers in non-supervisory positions in seven locales in the United States (located in New York, Massachusetts, Georgia, Texas, Wisconsin, New Mexico, and California), it is noted that their average hourly wage was \$4.29—41.6 percent higher than the average enlisted military member's hourly earnings.

Further reviewing the average 1973 earnings of non-supervisory civilian workers in 12 non-manufacturing industries, it is noted that their average weekly wage was \$171.00—41.3 percent higher than the average enlisted military member's weekly earnings.

Checking still further, an examination of the weekly earnings of production workers in 19 manufacturing industries proved that their wages were 35.8 percent higher than the average enlisted military member's weekly earnings.

Other facts may be obtained when considering the pay and allowances of the average "nonsupervisory or production" military member (paygrades E-6—E-1) with that of the last two civilian workers' groups noted immediately above:

1. In 1949, the civilians received average weekly earnings of 18.5 percent and 10.3 percent (respectively) more than their military counterparts—not including the military's tax advantage which would reduce the percentages noted.
2. In 1973, the percentages increased to 25.5 percent and 20.6 percent respectively—including the military's tax advantage.
3. In a 25-year period, the civilian occupations noted above increased their average weekly earnings by at least 7 percent and 10.3 percent respectively over their military counterparts.

In yet another area, the average military member (including all paygrades) received \$8,977 annually in 1973 pay and allowances. Department of Defense civilian workers averaged \$12,791 (1,033,000 employees with a \$12,994,000,000 payroll) the same year—a difference of 42.5 percent.

Although figures are not available for 1973, it is interesting to note that the average railroad worker earned \$10,600 annually in 1971. This was 18.1 percent more than the average military member (including all grades) earned in 1973.

Finally, in a reversal of what has been reported above, farm workers' wages in 1950 and in 1972 were examined against those of the military. It was found that during the earlier year the average military member in paygrades E-6—E-1 earned 101.7 percent more each week than the average farm worker. Twenty-two years later, the percentage was down to 84.9 percent—a 16.8 percent loss for the military member.

Fringe Benefits

In a recent New York Times dated March 2, 1975, reporter John W. Finney authored an article entitled "Military Pay Put Above Civilians." A synopsis of Mr. Finney's article follows:

"DoD is coming to the conclusion that the military, rather than being underpaid, is earning substantially more than the average civilian. In 1973, the Commerce Department estimates that the average military pay totaled \$8,977 a year while workers in civilian industry averaged \$9,106. However, if military fringe benefits were translated into pay, they would add roughly 25 percent to military compensation for a total of \$11,221. Of the 25 percent contributed to military fringe benefits, 8.3 percent is for retirement funding, 3.5 percent is for medical care, 3 percent is for commissary privileges, and 10 percent for housing."

DoD assumed that every military member, all 2,275,975 of them, received a full range of fringe benefits—yet the Defense Department admits that only 50 percent of that number would draw retirement annuities. Probably no more than that percentage shopped in commissaries and it is doubtful if any more than one-half of the military forces were living in adequate quarters or housing equal to the monetary benefit implied by that agency. No figures are available on medical care, but it is known that preventative medicine must be practiced on the healthy in order to keep them in that condition.

Joining DoD in its rationale that the military is earning more were certain Congressional committees (using DoD figures, of course). Some months ago, a Senate panel released an article to the press indicating that each soldier costs the Federal government over \$12,000 annually—and that figure would increase. By the time it was rewritten for publication, the reader no doubt believed that this was exactly the amount each soldier earned. In real fact, only an estimated 22 percent of military personnel (paygrades E-7 and above) earned anywhere near that figure.

In another report by the House Appropriations Committee, a special analysis for 1973 "hypothetical military compensation" was offered. Using nine different assumptions, it "proved" that military pay was something anyone would be happy to have as an annual wage. In another graph, the committee presented only seven different assumptions, but continued to present the same "delightful picture" that the military member was earning adequate "compensation."

However, if the percentages of each military paygrade or a combination of paygrades were weighed against the report, two significant points would be prevalent:

1. Only 33 percent of the total force earned more than \$11,221 in annual 1973 "hypothetical military compensation," and
2. Only 22 percent earned more than \$11,221 in "selected examples of annual compensation."

The committees, in either case, considered assumptions that do not and will not apply to the majority of enlisted members. For example, in 1974, 44 percent received full quarters and subsistence allowances. For E-6 and below it was less than 41 percent, for E-5 and below 36.5 percent, and for E-4 and below 31.5 percent. The remaining enlisted force (56 percent) were furnished government quarters, many dating back to World War II. (The Secretary of the Army noted that 40 percent of the Army's enlisted personnel, nearly two-fifths of the total enlisted strength of the Armed Services, lived in WW II quarters originally constructed to last five years.)

For the sake of argument, assume that all military members do receive 25 percent of their compensation in fringe benefits. But, what about the civilian workers? Aren't they entitled to fringe benefits—and were these considered when DoD made its "comparison?"

To answer the last question first, the reply would be "evidently not." Civilians are entitled to many benefits not included in statistical data prepared by governmental agencies to define annual wages. For example, there are more Federal employees than military personnel (2.7 million vs. 2.2 million). Yet Federal employees receive 32 percent of their base pay in fringe benefits or 7 percent more than that for the military. In non-governmental occupations, auto workers are reported to be receiving 55 percent in benefits. For other civilian sectors there were no estimates provided for such items as Christmas bonuses, room and board, gratuities, discounts for purchases, in-house medical care, employers' contributions to retirement funds, other special bonuses and allowances, etc.

Of course, certain tax advantages for the civilian community must be considered as it was for the military. Over 60 percent of American families are purchasing or owning their homes. Balanced against the military, civilian workers receive an equal if not greater tax advantage. Additionally, many civilians may deduct costs of uniforms and/or their maintenance, costs of moving (which is normally in excess of reimbursable amounts), medical costs in excess of 3 percent (the military is assumed to obtain 3.5 percent in compensation in this area), etc.

The military community does not deny it has certain fringe benefits, but insists that proponents of "comparability" accept the fact that these same benefits exist also for the civilian community. As the Honorable Richard C. White (Tx), Chairman, House Subcommittee on Retirement and Employees, stated in a recent press release: "The Civil Service employee is entitled to what he earns and has a right to expect the same protection of his individual rights as his counterpart in private industry."

That same right should equally apply to the military member.

As implied throughout this paper, proponents of military pay "comparability" continue to assume that every member of the Armed Services is provided with "compensation" and "fringe benefits" not afforded the civilian community, or even part of that community. This is an absolute falsity and should be considered as such by anyone or any group that attempts to review the two pay systems.

In researching data for this paper, no actual "compensation" or "fringe benefits" percentages were available for the majority of the civilian sector. It is apparent that if there were such figures, they might prove that military "compensation" is lagging behind civilian "compensation."

The main proponent has been and continues to be the Department of Defense. As the spokesman for the Administration, it has led the way to erosion of military pay, allowances, and benefits. No doubt it fears a greater cutback in defense appropriations by a more liberal Congress and believes that weapons are more important than military manpower. In this respect, it has and will continue to offer more reductions in military strength, more reductions in military pay and allowances, and more reductions in military benefits.

Congress wanted an all-volunteer force. Today the nation has that force and has the quality and quantity mix. Unfortunately, it may not last too long. The Department of Defense may bring it to a slow death with its constant attacks on military "compensation."

The Non Commissioned Officers Association of the USA (NCOA), representing more than 170,000 members of the U.S. Armed Forces, **of which 145,000 are on active duty**, recommends that Congress as well as the Administration await the report of the Defense Manpower Commission before further military benefits are reduced or eroded under the guise of "comparability."

The commission, made up of both former military members and civilians, is not under the mandate of the Department of Defense. Instead, it is a product of Congress charged to provide that legislative body and the President of the United States with the best answers available.

The NCOA places its trust and confidence in that commission. It believes that the "task force" will ultimately agree that military pay for the majority of service members cannot under the present systems be "comparable to" or "competitive with" civilian pay.

Reference Sources:

- THE WASHINGTON POST, March 6, 1975
- AIR FORCE TIMES, Feb. 19, 1975
- DoD Appropriations for 1974 and 1975—Part 1 (Hearings before Subcommittee of the Committee on Appropriations, House of Representatives, 93rd Congress—First and Second Sessions)
- Bureau of Labor Statistics, Dept. of Labor
(THE WORLD ALMANAC—1974)
(INFORMATION PLEASE ALMANAC—1974)
- CURRENT NEWS, Part 1, Early Bird Edition—0730, Mon., Mar. 3, 1975
- Economic Research Service, Dept. of Agriculture
- Uniformed Services Almanacs—1972 & 1973
- Interstate Commerce Commission
(THE WORLD ALMANAC—1960 & 1974)
- Committee Print No. 16, Committee on Post Office and Civil Service, 93rd Congress, Second Session, Feb. 1, 1974
- THE AMERICAN ALMANAC—1971 & 1973
- WASHINGTON STAR-NEWS, Sept. 7, 1974
- LEGISLATIVE GUIDE FOR THE MILITARY (Prepared by National Assn. for Uniformed Services—NAUS)

Statement by
Charles F. Conlon
Executive Secretary, National Association of Tax Administrators

We are very pleased to attend this Commission hearing on this matter of importance. I think if it is satisfactory to the Commission members and staff, I might proceed by calling first on the representatives of the state government who have made specific studies on the various aspects of the questions raised by the Commission report.

I would say, though, the Commission report is an excellent one. It certainly has sparked controversy which indicates, I think, that the topic is a very timely one.

I think the associates here from the state governments are in a position to make very useful comments on the matter from their own experiences and their own studies on the kinds of problems discussed in the report.

I will call first on Mr. William H. Forst, tax commissioner of the Commonwealth of Virginia, and also president of the National Association of Tax Administrators, who will present a few resolutions to you on some of these questions, and his own remarks on the income tax and the excise tax situation in his own state.

Statement of
William H. Forst

Tax Commissioner, Virginia Department of Taxation

Mr. Chairman, my name is William H. Forst. I am currently the president of the National Association of Tax Administrators.

At our recent meeting in St. Louis, we passed two resolutions specific to this particular hearing. I will read the pertinent sections.

"The National Association of Tax Administrators respectfully urges Congress to enact legislation to amend the *Buck Act* to permit state and local governments to impose general sales and selective excise taxes on sales made on military installations."

This resolution was unanimously adopted.

The other resolution, also unanimously adopted, was: "Be it resolved that the executive secretary of the National Association of Tax Administrators advise the appropriate officials of the Executive Branch of the Federal government and the United States Congress of the desire on the part of the states, as reflected by this resolution, that action be taken to institute a requirement that withholding for state income taxes from the pay of members of the Armed Forces be instituted, and, be it further resolved, that in order to accomplish this, action should be taken to amend Public Law 82-587 (July 17, 1952) which presently prohibits such withholding."

I have a statement prepared by the National Tobacco Tax Association which I will leave with you. The National Tobacco Tax Association, like the NATA, is a constituent organization of the Federation of Tax Administrators. The NTTA report is based on a survey of the state tobacco tax administrators, to determine their estimated loss of revenue and to document the enforcement problems that are encountered because of the exemption. I am also leaving a statement prepared for the Tobacco Tax Conference by Robert Woolsey, director of tobacco products tax division in Texas.

In Virginia we have a very high concentration of military personnel, primarily in two areas, around Washington, D.C., and in the Norfolk area.

In two counties adjoining Washington, D.C., for instance, Arlington and Fairfax Counties, the 1970 Census indicated that 12 percent of the total labor force, and 20 percent of the male labor force consisted of active duty military personnel. The Norfolk area, where the Naval bases are located, undoubtedly has an equally high concentration.

According to figures developed by ACIR, Virginia lost over \$10 million in state sales taxes in 1973 due to state-local tax exemptions on military base sales. It lost approximately \$1.7 million in cigarette taxes; \$4.6 million in alcoholic beverage taxes; and, based upon our estimates, about \$7.5 million as a result of not being able to keep track of Virginia residents in military service because we have no withholding provisions.

That amounts to about \$24 million a year in the state. Also, in the Washington area you can add another \$3.4 million because of local 1 percent sales taxes exempted at military installations.

Virginia has a very low cigarette tax rate. However, we do have, in Norfolk, a 10 cent a pack local rate. There is a similar local rate in Alexandria and in Arlington County. Our reports show that Virginia has a higher than average consumption of cigarettes. I think you will find that a lot of that is due to purchases being made in Virginia by people in the D.C. area, because of the tax break.

Virginia is very adversely impacted by the sales and excise tax exemption, and I think the time has come for this exemption to be eliminated.

One of the most delinquent areas in our individual income tax accounts receivable are the military personnel. We just cannot go out and collect these bills. The withholding would certainly eliminate that particular problem.

Statement of
William Barnes
Chief of Sales and Income Tax, Mississippi Tax Commission

I certainly appreciate this opportunity to appear before you. I would like to address myself to the one point of the sales and excise taxes on alcoholic beverages, in view of a recent unfavorable ruling on the matter in a case before the United States Supreme Court.

Since 1966, Mississippi has been a "controlled state." We are the exclusive wholesaler of alcoholic beverages, but anyone wanting to go into the retail sale of alcoholic beverages is permitted to do so on making application and qualifying under certain provisions. There are permits to sell by the drink, and permits to sell by the bottle.

All our alcoholic beverages are marked up 17 percent and sold at a uniform sales price across the state. In addition, Mississippi has a 5 percent sales tax on the purchases. A person who lives 200 miles from Jackson, Mississippi, can buy a case of alcoholic beverages at the same price as if he lived directly across the street.

Prior to 1966, alcoholic beverages were sold on military bases in Mississippi, and there were no constraints to discourage such sales. We recognized that this was under the control of the Federal government.

When we became a controlled state, we felt the military should buy their alcoholic beverages from the State of Mississippi as we were the exclusive wholesaler of the alcoholic beverages.

We had several conferences with the military, and it was finally determined that we would continue to permit them to buy directly from the manufacturers of these products since there was some price differential and they could buy it cheaper directly from those manufacturers. But the understanding was that the mark-up on the alcoholic beverages would be the same as it would have been if the state had sold it to the military—17 percent.

We felt that the state should realize a 17 percent mark-up on alcoholic beverages since under Mississippi law we were the exclusive wholesaler of alcoholic beverages in the state. The military paid this for a number of years, but then it decided this mark-up was essentially an excise tax. The case went to the United States Supreme Court. The court agreed that the 17 percent mark-up was an excise tax that the State of Mississippi was attempting to impose on the military. We lost our cause, and we are now attempting to negotiate with them.

We are not in a squabble as to where they should buy their alcoholic beverages. Basically, our problem is three-fold. Number one, the military pays no 5 percent sales tax on the sale of alcoholic beverages on military bases.

Secondly, they are not required to have a permit for the sale of alcoholic beverages; and finally they do not pay the 17 percent mark up on alcoholic beverages.

We feel that the military is in a position to sell its alcoholic beverages, most of which is consumed off base, at a price which is roughly 25 percent less than the price from off-base.

With the inflation in prices, we are naturally looking into areas that are perhaps escaping taxation or where there is a tax inequity. This is one of the areas where we think we could pick up several million dollars in additional revenue without imposing additional taxes upon the citizens.

The second area that I would like to address myself to is the experience we have had in attempting to use the W-2 information furnished to us by the various military services. The forms we receive often have no names or addresses or the copies that we receive are so light they are impossible to read.

As Mr. Smith has previously stated, the forms we receive often have no names or addresses or the copies that we receive are so light they are impossible to read.

We tried to tie these W-2 forms into a program of correlating the Federal tapes with the state tapes in our computer system. In developing such a system, we wrote approximately 36,000 letters on November 14, 1974.

As a result of those letters, we nearly stopped operations on the military installations within the state. We received letters from many people who said that they were not legal residents of the State of Mississippi, that their place of domicile was in some other state, and that we were completely in error in writing to them.

This created such a problem that we cancelled the program. We were completely frustrated in writing to these people. It is just natural that people should write to the governor. I think that I spent the whole month of December, trying to justify my actions to the governor's office rather than dealing with tax problems. We made a lot of military people mad and when you do that they naturally write to the higher officials. So, I had quite a problem justifying it.

The program, frankly, is not working out. We are not getting correct or adequate information. We would like to see a system of withholding. In this A-38 program, we need information we can effectively utilize.

Statement of
Eldred J. Kelley
Staff Assistant, Excise Taxes, California State Board of Equalization

California has a substantial stake in whatever action may be taken to permit state and local taxation of tobacco sold through military facilities.

The on-base sales to military personnel in California are more than twice the volume of the next highest state, amounting to approximately \$880 million annually. Sales of cigarettes constitute about \$60 million of this amount.

If the California cigarette tax was applied to military sales of cigarettes, the state would receive approximately \$22 million additional tax revenue annually.

The California State Board of Equalization, which administers the cigarette tax along with sales tax and the other excise taxes, does not have an official position, however, on whether the *Buck Act* should be amended to permit state and local taxation of tobacco products.

The California cigarette tax law exempts from the tax, sales of cigarettes to the United States Army, Air Force, Navy, Marine Corps and Coast Guard exchanges and commissaries, Navy and Coast Guard ship's stores and the United States Veterans Administration.

There is presently before our legislature a bill to repeal that exemption. If the exemption is repealed, however, we see no increase in cigarette tax revenues since shipments of cigarettes to these Federal facilities may be made in interstate commerce without subjecting them to the state tax.

Sales to officers' clubs and messes and NCO clubs are presently taxable to the cigarette distributors when delivery is made from in-state warehouses. Virtually all such shipments are made from out-of-state locations and, hence, are exempt from the California tax.

So, also, are direct purchases from manufacturers in interstate commerce by Federal correctional institutions.

As in other states, the California cigarette tax is collected at the distributor level. If Federal legislation is enacted to permit state taxation of tobacco products sold on military bases, such legislation should include permission for states to collect the tax from the military installations as distributors, or provide for direct taxing by the states of cigarettes shipped by manufacturers across state lines to military and Veterans Administration facilities. The collection of tax from the consumers is impossible, since the cost of collection exceeds the revenue.

During the years that the California cigarette tax was three cents per pack, cigarette deliveries to military and Veterans Administration outlets in our state were 5 to 6 percent of the total California deliveries.

In the fall of 1967, the tax rate was increased to ten cents per pack. During the first year of the increase, military deliveries jumped 30 percent in volume and have remained at between 7 and 8 percent of total California distributions since that time.

The computed per capita consumption of cigarettes for the military store patron population, age 18 years and over, averages 74 packages per year higher than that for civilian store patrons in California.

I do not suggest that these differences are related to bootlegging operations; perhaps the tax increase made military retirees with commissary privileges more conscious of the need to purchase their cigarettes on base. For whatever reason, the relationship of increased on-base sales to the tax increase from three to ten cents per pack was very clear.

Military commanders and Veterans Administration officials have been highly cooperative in limiting sales of cigarettes in commissaries and exchanges to two cartons per customer. They have also taken action, in many instances, that have come to our attention, to discipline individuals who were observed making numerous two-carton purchases within a short span of time.

It is impossible, of course, for the commissary clerks to control less frequent purchases which are substantially in excess of the needs of the patrons and their families.

Our board has a broad program of inspecting cigarette packages offered for sale in vending machines and retail outlets. As a result, bootlegging has never gained a real foothold in California. Some confiscated cigarettes have been purchased from military supplies or, in a few instances, have been stolen from those stocks. The total volume that has come to our attention, however, has been quite small.

Seventy percent of California cigarette tax revenue goes into the state general fund; 30 percent is subvented to cities and counties for support of local government.

The state has preempted the field of tobacco taxation since the tax increase in 1967.

Public education in California is supported in large part by state funds. Nearly half of the state general fund revenues are devoted to education.

The argument is often made that to the extent military cigarettes are exempt from state excise taxes, civilian smokers are subsidizing the education of military dependents.

Again, I emphasize that the board takes no position on whether such asserted subsidy should continue.

Similar to the application of cigarette taxation, tobacco products, alcoholic beverages, and other tangible personalty, except food products, are subject to state and uniform local sales taxes when sold through civilian outlets.

California would therefore have a stake in any legislation which would permit application of these taxes to sales on military bases.

The alcoholic beverage tax is presently collected from distributors and wine growers for distilled spirits and wine delivered to military bases in California. Beer sold to most military entities is exempt by statute from the California alcoholic beverage tax. A bill is now before the California Legislature to repeal this exemption.

Recently, at one of the Army depots, military officials called the state office in the area and said they had some cigarettes they would like us to pick up. This fellow was observed by the commissary clerk to go through a line, buy two cartons, and go through the next line and buy two cartons, and go through the next line and buy two cartons. He had accumulated 24 cartons in just a few minutes.

They have put forth an excellent effort in California and our relations have been good.

Statement of
Daniel G. Smith

Administrator, Income, Sales, Inheritance and Excise Taxes
Wisconsin Department of Taxation

The ACIR report on differential taxation of military personnel has correctly represented the status of state income taxation of military pay of military personnel. The current system is laden with inequities, lacks uniform application, is subject to misunderstanding, and suffers from under-participation. All this is due in part to confusion, in part to purposeful avoidance, and in part to a Federal inattentiveness to state problems and to the needs of Federal employees who have state responsibilities.

I would like to review with you the experience my state has had with the income taxation of servicemen, provide you with a few statistics from studies we have made, and indicate what I think must be changed in order to provide for more equity and certainty in the tax collection function as it relates to members of the armed services.

Wisconsin's Law

Wisconsin's personal income tax law closely follows Federal law—as do those of most other states. In computing their tax, our citizens start out with Federal adjusted gross income, adjust that figure upward or downward by something called modifications—examples of which are made for US Bond interest, capital gains, a \$1,000 deduction from Armed Forces pay, etc. The result is the Wisconsin Adjusted Gross Income. From this, taxpayers may elect Federal itemized deductions, or use a standard deduction or low-income allowance. Thus, for a serviceman, all of the considerations given combat and hospitalization pay, exemptions for subsistence and quarters allowances, treatment of re-enlistment pay, and mustering-out bonuses, etc., are identical to those provisions under the Internal Revenue Code.

Wisconsin and 26 other states have a domiciliary law with respect to the taxation of the earned income of its residents. Under a "domicile" law, a "legal resident" must file a tax return with his "home state" and report thereon all income received during the year, regardless of where earned. If the individual does not file a return for any year(s), the statute of limitations does not toll on those periods not covered by a return.

Compliance Problems

Over the years, Wisconsin's Department of Revenue has matched its computer lists of taxpayers with the Internal Revenue Service records and has compared the wage statements it receives from the armed services with its files of returns for the purpose of locating non-filers. In spite of this, we have discovered—with unfortunate regularity—members of the armed services who have not filed in Wisconsin for many years, and who at time of discovery have accrued large—and at times, staggering—delinquencies for a number of filing periods. It is not uncommon to discover for the first time the identity of a recently retired serviceman, who has returned to Wisconsin, and who has not filed returns for his entire tour of duty, and who now owes the state anywhere from \$10,000 to \$20,000 in back taxes. Frequently, these individuals entered the service from Wisconsin prior to establishing a tax file with our department, did not establish domicile elsewhere during their term of service, and filed their Federal returns in another state. For some unclear reason we did not receive wage statements for these individuals as is required under *OMB Circular A-38*.

In preparation for a discussion with officials of the Department of Defense to look for ways by which Wisconsin could increase its information about its servicemen, I had our staff precisely count and examine all wage statements received from the Armed Forces for the 1974 tax year. At about the same time, and unknown to me then, the ACIR began its present study. The data ACIR gained from the

Pentagon about the number of Wisconsinites in the service has been compared with the data Wisconsin collected in its wage statement survey. The results can only be described as disturbing.

The Department of Defense advised ACIR that 29,271 Wisconsin domiciliaries earned military income in the continental United States during 1974. Wisconsin received only 15,551 wage statements from the military for that same year. Only about one-half (53 percent) of the information documents Wisconsin should have received from the Department of Defense were received (see Table).

Additionally, the statements were haphazardly prepared. The Army sent us 20 percent of what they should have. And, of what was submitted, only 55 percent showed a mailing address. The Navy sent us 65 percent of the wage statements they should have. However, only 13 percent of those received provided an address.

From all of the services, we received W-2 type wage statements from 332 separate locations. Although some of the reports were received in November and December 1974—presumably for employees who had terminated service by that time—and a large number were filed by the date specified in the OMB directive, a large number were filed late. Thirty-nine percent of those received from the Army were received in March and April 1975; 21 percent of the Navy's submissions were more than two months late; and 93 percent of those from the Marine Corps were received after March 1.

Wisconsin routinely compares computer tapes of its lists of income tax filers with those created by the Internal Revenue Service. However, under this procedure, a state is restricted to IRS records for individuals showing a mailing address in that state. Thus, if a Wisconsin domiciliary files a Federal tax return with a Texas address, this computer tape procedure will not detect the individual's non-filing with his home state. Further, if his branch of service fails to send Wisconsin a wage statement, it is not likely our revenue department will become aware of his existence, unless he had established a tax record with the state prior to enlistment. It is doubtful that this individual will meet his state tax responsibility until he leaves the service, and then only if he returns to Wisconsin for his post-service years.

If one reads the policy statements in *OMB Circular A-38*, it would seem that the services are not fulfilling their obligations under that directive. In Section 2 of A-38, it is specified that "(I)t is the long-established policy of the Federal government that its employees have an ethical responsibility to pay their just taxes, whether Federal, state, or local, on the grounds that such taxes are the responsibility which every citizen must meet. . . . Executive departments and agencies are periodically instructed . . . to bring this policy to the attention of their respective employees." If the reporting requirements of A-38 are in consonance with the established policy of cooperation between the Federal government and the states, it seems to me that the services need to be reminded of those requirements.

The problems of the states do not end with identifying military personnel who should file returns or with determining the correct incomes subject to tax. Getting servicemen to pay is, on occasion, troublesome. Unlike other taxpayers, their wages are not subject to withholding. Some servicemen will file returns, compute their tax due properly, and mail the return to the state tax agency without a remittance. Unless state tax collectors can coax the amount due from a reluctant serviceman by a series of collections letters, there is little else they can do to close the account.

Military wages cannot be attached. Unless the individual owns property in the state on which levy can be taken, a state is powerless to collect the tax due. Although military officials frequently counter this complaint with a suggestion that state tax authorities ask the individual's commanding officer to intercede, it is doubtful whether this approach can be effective or legal. In many states such revelations may constitute a breach of the confidentiality provisions of the tax law, especially when such information is made known to non-withholding employers.

In Wisconsin, the average annual amount of income tax added to our delinquent accounts receivable for servicemen is \$450,000. Less than 40 percent of this amount is eventually collected.

Jurisdictional Issue

With respect to the two alternatives available on the jurisdictional issue, I recommend the alternative to remove the stipulation that only the service member's state of domicile or legal residence can tax his active duty military pay with the suggestion that it be made explicit that the serviceman's state

of domicile will retain the power to tax its own domiciliaries and that the state of domicile allow a credit against its tax for taxes paid on the same income to another jurisdiction.

In recognition of the fact that military personnel are frequently stationed outside the state of domicile and with the understanding that this group demands less of the state than do other citizens, many states allow exemptions or exclusions from military pay in arriving at net taxable income. This would seem to be a matter of judgment for each state's legislative body to consider. For this reason, I recommend elimination of the sentence which recommends that those states whose income tax laws now expressly exclude from taxation all or part of the active duty pay of military personnel who are not domiciled in the state act to remove such exclusions.

Changes to Aid Compliance and Administration

As far as the four alternatives available with regard to Federal changes to facilitate administration and compliance, I recommend the alternative to require withholding with certain modifications or changes in emphasis.

As presented, this alternative incorporates some, or all, of the provisions set out in other alternatives. Those parts dealing with improved changes in the military's performance under *OMB Circular A-38* are essential if withholding is not achievable; those recommendations pertaining to additional data on Federal Forms 1040 and 1040A are highly desirable, while the suggestion regarding allotments is necessary for quarterly payments of estimated tax only if withholding is denied.

The significant changes presented in another alternative are essential if the states are to better manage their tax collection function. For too long, irresponsible Federal employees have been able to rely on Federal immunity from state court actions in the matter of collection of state and local taxes. Such defiant non-payment of taxes discriminates against other members of the military and Federal civil service who pay their taxes promptly and fully.

The Commission may wish to consider an amendment to this particular alternative. Garnishment actions are severe, and they must be repetitively made to satisfy large, outstanding delinquencies. In Wisconsin, we adopted and use with regularity a law which permits the revenue department to certify a delinquency to an individual's employer with the requirement that the employer withhold not less than 10 percent, nor more than 25 percent of the taxpayer's wages each pay period for the purpose of satisfying an established tax deficiency. This deduction is in addition to regular withholding. The employer withholds such sums and submits amounts accumulated at the end of each calendar quarter to the revenue department. The procedure described permits a guaranteed installment payment plan over a period of time during which the employee's tax delinquencies are satisfied. However, it avoids the devastating effects that wage garnishment actions have on an employee. (A copy of Section 71.135, Wisconsin Statutes, is at the end of this testimony).

A similar proposal for delinquent tax withholding could be effective in collecting state taxes from Federal employees. Each state could certify an amount delinquent to the Secretary of a service and direct that the payroll department deduct and account for delinquent taxes in the same manner as the services now account for allotments.

The strongest alternative, which would require withholding of state and local income taxes from military pay, should be amended to provide some indication as to which state or states are entitled to withholding. The recommendation should specify that the post of duty state is entitled to withholding on all military personnel stationed there. However, if a serviceman is stationed in a state which does not tax military pay, then withholding should be made for taxes imposed by the serviceman's state of domicile. Similarly, when a serviceman is outside the continental limits of the United States, withholding should be directed to his home state.

The distribution of servicemen throughout the various jurisdictions in the United States is uneven. If you look at *Table 1* of the ACIR report, you will find that of the four largest states reporting on-base sales to military personnel in fiscal year 1973 (41 percent of total sales), three of those states essentially do not tax military wages at the present time. If servicemen domiciled elsewhere were stationed in those states, they would not be subject to withholding, and all the changes recommended would be for naught, since they would not have met their tax responsibilities to their home state on a pay-as-you-go

basis. It seems that servicemen from Wisconsin (or North Carolina, Ohio, Virginia, Massachusetts, Montana, Colorado, etc.) stationed in Florida or Texas would not be subject to withholding under the provisions in the strongest alternative as drafted. A modification is required to specify that in the absence of withholding in the post of duty state, withholding should be made for the individual's state of domicile.

According to approximations presented by employees of the Defense Department at the ACIR critics' session in June 1975, 25 percent of the Armed Forces are stationed outside the continental limits of the United States. If states were restricted in their withholding on the incomes of servicemen to those states in which they were stationed, substantial amounts of income would be outside the withholding scheme provided. There are approximately 27 jurisdictions which have a domicile law and which require reporting of all income, regardless of where earned, to the state of legal residence. To allow domiciliaries of a state stationed outside the continental limits of the United States a complete exemption from state income taxation would continue a distinction for military personnel and provide a benefit not allowed their civilian counterparts. To prohibit withholding in such instances would create a budgeting hardship on those members of the military so situated.

Sales and Excise Taxation of On-Base Sales

When originally established, post exchanges and commissaries were intended to provide military men and their families with the necessities of life while stationed at out-of-the-way posts of duty. Further, special economic benefits in the form of modest pricing of goods sold were accorded this group, since their pay then was substantially less than that of their civilian counterparts. Neither of these conditions holds today.

It is recommended that this Commission urge Congress to give early and favorable consideration to legislation amending the *Buck Act* to allow application of state and local sales and excise (including cigarettes, tobacco products, and liquor) taxes to all military store sales in the United States.

In addition to the very persuasive arguments provided in the report supporting this recommendation, the Commission should be reminded that the economic circumstances of servicemen and military retirees have changed, to the extent that changes sought in this recommendation now are clearly affordable. Changes in military pay over the past few years have resulted in significant across-the-board increases for all uniformed employees. Yet all the tax benefits given servicemen under Federal and most state tax laws remain unchanged. Subsistence, uniform, and quarters allowances are not taxable. Housing and cost-of-living allowances to cover excess cost of quarters outside the United States are not considered income. Family Separation Allowances are excluded from gross income. These payments made to a non-military wage earner do not receive similar tax treatment.

It is my understanding that the retirement program for the military does not require employee contribution. Under recent change, military retirement benefits for both enlisted men and officers are increased every three months to reflect changes in the cost of living and when such adjustments are made, this cost-of-living adjustment is 1 percent above the actual cost-of-living increase recorded. Unlike their civilian counterparts in the Federal employ, FICA deductions are withdrawn from wages, and all military retirees are eligible for social security benefits in addition to retirement pay.

If the reports are correct that the Department of Defense indirectly subsidizes commissaries with facilities and services and directly subsidizes them with Congressionally appropriated funds, and if these subsidies save commissary customers an average of 20 percent on their purchases compared to prices paid by shoppers at off-post retail outlets, then removal of the state and local sales and excise tax exemption will only decrease the difference between these sales prices, not eliminate it. If a serviceman can now buy for \$80 merchandise that would cost his civilian neighbor \$100—before tax—the difference in purchase price under current law to the two individuals is \$24, assuming a 4 percent sales tax rate. Modification of the *Buck Act* to permit imposition of sales tax on commissary sales will reduce that difference to \$20.80. This is still a bargain for the serviceman, not available to the civilian. It is difficult to understand how the Department of Defense can resist this change, when the direct consequences are slight to the individual purchaser, considering the residual benefits retained, but are of great significance to state and local governments.

**Summary of Wage Information Statements Submitted to
State of Wisconsin for 1974 Under
Provisions of OMB Circular A-38**

(RECEIVED FROM NOVEMBER 1974 THROUGH APRIL 1975)

Service Branch	Number of Active Servicemen Per Defense Dept. ¹	Number of Locations Submitting Wage Statements	Number of Wage Statements Received	Percentage of Wage Statements with an Address
Army	7,580	63	1,536	55%
Air Force	9,421	3	4,577	100%
Marines	3,982	11	6,136	98%
Navy	<u>8,288</u>	<u>255</u>	<u>5,456</u>	13%
Subtotal	29,271	332	17,705	
Less: Marine Reservists and Retirees ²	—	—	- 2,154	
TOTALS: Dept. of Defense	<u>29,271</u>	<u>332</u>	<u>15,551</u>	
Coast Guard	Not Available	17	530	100%

¹Reported to ACIR.

²Conservatively estimated to be number of forms received less number of active servicemen reported to ACIR.

Section 71.135, Wisconsin Statutes

71.135 Withholding by employer of delinquent income tax of employe. (1) Any assessor of incomes of the department or his authorized representative may give notice to any employer deriving income having a taxable situs in Wisconsin (regardless of whether any such income is exempt from taxation) to the effect that an employe of such employer is delinquent in a certain amount with respect to state income taxes, including penalties, interest and costs. Such notice may be served by registered mail, or by delivery by an employe of the department of revenue. Upon receipt of such notice of delinquency, such employer shall withhold from compensation due or to become due to such employe, the total amount shown by the notice. The assessor of incomes or his authorized representative, in his discretion, may arrange between the employer and such employe for a withholding of an amount not less than 10 per cent of the total amount due the employe each pay period, until the total amount as shown by the notice, plus interest thereon, has been withheld. In no event shall the employer withhold more than 25 per cent of the compensation due any employe for any one pay period, except that, if the employe leaves the employ of the employer or gives notice of his intention to do so, or is discharged for any reason, the employer shall withhold the entire amount otherwise payable to such employe, or so much thereof as may be necessary to equal the unwithheld balance of the amount shown in the notice of delinquency, plus delinquent interest thereon. In crediting amounts withheld against delinquent income taxes of an employe, the department shall apply amounts withheld in the following order: costs; delinquent interest; delinquent income tax. The "compensation due" any employe for purposes of determining the 25 per cent maximum withholding for any one pay period shall include all wages, salaries and fees constituting gross income under S. 71.03(1)(a) when paid to an employe, less only amounts payable therefrom pursuant to a garnishment action with respect to which the employer was served prior to his being served with the notice of delinquency and any amounts covered by an irrevocable and previously effective assignment of wages, of which amounts and the facts relating thereto the employer shall give notice to the department within 10 days after service of the notice of delinquency.

(2) In any case in which the employe ceases to be employed by the employer before the full amount set forth in a notice of delinquency, plus delinquent interest thereon, has been withheld by the employer, the employer shall immediately notify the assessor of incomes in writing of the termination date of the employe and the total amount withheld.

(3) The employer shall, on or before the last day of the month next succeeding every calendar quarter, remit to the office of the assessor of incomes the amount withheld during the calendar quarter. Any amount withheld from an employe by an employer shall immediately be a trust fund for the state of Wisconsin. Should any employer, after notice, wilfully fail to withhold in accordance with the notice and this section, or wilfully fail to remit any amount withheld, as required by this section, such employer shall be liable for the total amount set forth in the notice together with delinquent interest thereon as though the amount shown by the notice was due by such employer as a direct obligation to the state of delinquent income taxes, and may be collected by any means provided by law including the means provided for the collection of delinquent income taxes. However, no amount required to be paid by an employer by reason of his failure to remit pursuant to this section may be deducted from the gross income of such employer, pursuant to either S. 71.04 or 71.05. Any amount collected from the employer for failure to withhold or for failure to remit pursuant to this section shall, for purposes of distribution, be treated as a tax paid by the employe.

(4) The provisions of subs. (1) to (3) shall be applicable in any case in which the employer is the United States or any instrumentality thereof or the state of Wisconsin or any municipality or other subordinate unit thereof except those provisions imposing a liability on the employer for failure to withhold or remit. But an amount equal to any amount withheld by any municipality or other subordinate unit of the state of Wisconsin pursuant to this section and not remitted to the assessor of incomes as required by this section shall be retained by the state treasurer from funds otherwise payable to any such municipality or subordinate unit, and transmitted instead to the assessor of incomes, upon certification by the secretary of revenue.

(5) The department of revenue shall refund to the employe excess amounts withheld from the employe under this section.

(6) Employers required to withhold delinquent taxes, interest and costs pursuant to this section shall in no case be required to withhold amounts other than the total amounts certified to such employers by the department and in no case shall such employers be required to compute interest, costs or other charges to be withheld.

Statement of
Robert J. Woolsey
Director of Tobacco Products Tax Division
Comptroller of Public Accounts, Austin, Texas

(Prepared for the 49th Annual Meeting of the National Tobacco Tax Administrators)

When we were requested to appear on this panel to discuss the military cigarette problem in Texas, we were already in the early stages of trying to update our information on the various military installations across the state. We have just completed a survey by comptroller field personnel which we believe will show what the military is doing to control the excessive purchases of tax-free cigarettes and where the problem areas of abuse exist.

The Size of the Texas Military Problem

One fact is evident, Texas is well blessed with military installations. There are 14 Air Force bases, three Army bases, five Naval bases, and three U.S. Coast Guard stations in the state. Tax-free cigarettes are sold from a composite total of 28 commissaries, 119 exchanges and branch exchanges, and at least 50 other assorted locations, making almost 200 places where active and retired military persons and their dependents can purchase tax-free cigarettes.

During June 1975, tax-free cigarettes sold to all branches of the military population totaled 230,339,000 cigarettes. When stated in terms of cigarette tax revenue at the Texas rate of 18.5 cents per package, the military annually consumed \$25.5 million in potential tax revenue. For this reason, we are taking a serious look to see what might be done in cooperation with military officials to curb the apparent abuse problems which appear to be more prevalent at some installations than others.

Although the actual military strength of a base is considered classified information, we have been successful in obtaining from the base commanders the relative base strength for 1973 and 1974 stated as a percent of 1975 strength (1975 = 100 percent).

It is rather simple to show that an abuse problem exists when the 1975 cigarette consumption level for a particular base is running above the 1973-74 consumption level even though the base commander will admit that 1975 base strength is running 10-15 percent below the 1973-74 level.

Also, by knowing from cigarette manufacturers' data tapes the number of cigarettes purchased monthly by a military facility, simple mathematics will show that if one out of five active and retired personnel consume eight cartons of cigarettes per month, the approximate strength of the facility can be computed. Only the base commander knows from the computed value if a substantial cigarette abuse problem exists. Armed with this knowledge, the base commander can be persuaded to crack down on the abusers.

It is impossible to know the extent to which tax-free military cigarettes are being consumed by unauthorized Texans, but we suspect that the abuse problem may be costing the state \$5 to \$6 million annually. When compared to the \$260 million we expect to collect on cigarette taxes this year, the military problem may seem relatively obscure, but nevertheless, a problem we believe to be deserving of much more attention than we have been giving it in the past several years.

Routine Methods Used To Control Cigarette Purchases

The comptroller's survey showed that there is a great variance from one base to another as to how seriously each operation takes the abuse of PX and commissary privileges. It is almost inconceivable that two military instrumentalities following the same military regulation manual can interpret those regulations with such latitude. One base may be ultra-strict with very few loop holes to tempt abusers while another base may operate so loosely as to almost encourage abuse.

—Published Warnings: All bases surveyed published articles in the base newspaper on abuse of commissary and PX privileges in general. Very few articles were directed toward the cigarette abuse problem in particular. The frequency of any type printed article dealing with commissary and PX privileges varied from a weekly publication to twice yearly.

—I.D. Cards Required: All bases required that each person entering the commissaries either be in uniform or show a military I.D. card before being admitted. All but six of the 28 bases also required that persons show proper I.D. to the checker before being allowed to make the cigarette purchase.

—Actions Taken to Limit Cigarette Quantity at the Point of Sale: All cigarette purchases were generally limited to two cartons although there was almost no attempt to regulate the number of times a person could buy cigarettes during a day or week.

Each base seemed to have its own special formula to be applied for persons who qualified to purchase more than the customary two cartons. Generally, persons going on leave could present a copy of their orders to obtain extra cigarettes. Also, some consideration was given to retired military persons who live some distance from the base. The criteria for buying extra cigarettes range from being out-of-city residents, to persons living 20, 40, 60 or more miles from the base. The number of extra cigarettes also varied from four to ten cartons.

Special Actions Taken to Control Cigarette Sales

A very few military facilities had made a special effort to see that unauthorized consumption was curtailed.

—The Card System: The most elaborate system observed made use of a card system whereby the military person or his dependents were required to sign a cigarette sales slip. The slip recorded the purchaser's I.D. number, name (sponsor's name if a dependent), date of purchase, and the quantity of cigarettes purchased. These slips were sent to the accounting officer daily to be posted to the proper card. In this way, a constant review could be made of all excessive purchases regardless of the number of different locations from which cigarettes were purchased.

—Dollar Control of Total Purchases: One base accounting officer periodically records the total dollar amount of all purchases corresponding to the military person's I.D. number in an attempt to discover if any persons are making excessive purchases when compared with available income.

—The Blitz or Shake Down: Less than one-fifth of the Texas bases made a monthly "blitz" or "shake down" to see if vehicles leaving the base were carrying excessive cigarettes or other controlled items. The majority of the bases were reported only to stop and search vehicles during short intervals three or four times per year.

Suggested Ways to Make Unauthorized Consumption More Difficult

It is apparent that most of the problems of cigarette sales abuse at military installations come from the fact that each base has too much latitude to establish, or more frequently not to establish, a tight security for handling cigarettes.

—Establish Uniform Control Procedure: If at all possible, an effort should be made on a national level to spell-out by specific regulation the exact type of security measures to be taken in controlling the sale of cigarettes on a military installation so that a strict and uniform procedure would prevail at all bases.

—Manual or Computerized Matching System: Each military facility should implement a cigarette purchaser identification system which would use either a card posting system or a computer generated

matching system which would detect excessive purchases of cigarettes resulting from several points of distribution throughout the base. The deterrent effect of this type system would almost totally stop excessive purchases of cigarettes. Since the state would benefit directly from this type effort, an offer by the state to furnish data entry and computer time to do the matching of cigarette purchase records might be all that is required to get the program started. The matching of purchase records on a quarterly basis would probably maintain a good level of control.

—Punch Cards: A control punch card could be issued to each military person and dependent. This card would be punched, dated, and the quantity of cigarettes entered by the commissary or PX checker. This procedure could easily limit the number of cigarettes per week to two cartons per person.

—Reduced Purchase Limits: A reduction in the number of cigarettes purchased at one time would also slow down the opportunity for abuse. A person limited to purchasing one carton is less likely to spend time going back for more cigarettes than a person who can buy two cartons at each purchase.

**Statement of the
National Tobacco Tax Association**

**Based on Replies to a Survey of Tobacco Tax Administrators'
Views on Current Military Exemption to Cigarette Taxes**

The National Tobacco Tax Association, like NATA, is a constituent organization of the Federation of Tax Administrators. In response to the ACIR report, NTTA has surveyed state tobacco tax administrators as to (1) their estimates of revenue lost as a result of the tax-free sales of cigarettes on military bases and (2) enforcement problems they have encountered because of the exemption.

The replies affirm the ACIR findings as to the monetary importance of the military exemption in state cigarette taxation. *Table 3* of the ACIR report indicates that the states are losing some \$130 million annually in revenue because military sales of cigarettes are free from state tax. That amount is about 4 percent of total state tobacco tax collections. Even more impressive is that, as shown by ACIR, the estimated \$130 million tobacco tax loss compares with an estimated loss of \$135 million sales tax loss as a result of tax-free retail sales on military bases. When one considers that state sales tax revenue is more than seven times the size of state tobacco tax revenue, the fact that the tobacco tax loss attributable to the military exemption is nearly as large as the estimated sales tax loss is striking evidence of the role which the tax-free sale of cigarettes plays in the military exemption picture.

Areas of State Concern

The replies to the NTTA survey show that the state tobacco tax administrators have two principal areas of concern with respect to the exemption of the sale of cigarettes by military stores.

The first concern is the one already noted—namely that the loss in cigarette tax revenues that would otherwise be collected if there were no military exemption is substantial. The administrators raise the question as to the justification for that loss in revenue. Several ask whether the traditional reasons given for the military exemption still apply, in light of the present level of military pay. Several point out that, in practice, the military exemption has resulted in a shift of cigarette purchases away from local retail sources to the military stores. They note that the bulk of military purchases is directly from manufacturers, and they point out that a vendor type tax on cigarettes which would not be violative of the *Buck Act* prohibitions, could not, as a practical matter, be imposed on the military base sales of cigarettes, since the exchanges could avoid such a tax merely by having all their cigarettes shipped to them from outside the state.

The second area of concern is that the tax-free sales of cigarettes by the military open avenues of tax evasion through their availability to unauthorized persons, resulting in an illicit and continuing drain on state cigarette tax revenues. This form of tax evasion is extremely difficult to control, since it is a regular process, occurring in small quantities. Several states report that the military commanders have been cooperative in limiting the number of cartons authorized personnel may purchase at one time. However, a continuing, if smaller, volume of tax evasion is possible even with these limitations, and states have reported finding unstamped cigarettes obtained from military stores being sold through vending machine or other outlets.

The fact that there is a continuing purchase of tax-exempt cigarettes is evidenced in the statistics in both the ACIR report and in the state tobacco tax administrators' replies, which show per capita consumption of cigarettes by servicemen (based upon military cigarette sales) to be inordinately higher than the average per capita consumption rate. The difference is so great that it appears to be necessarily attributable in a large part to the fact that the number of persons smoking cigarettes sold by military stores is substantially greater than the number of persons authorized to purchase such cigarettes.

State Cigarette Tax Revenue Loss

The ACIR report contains, for each state, estimates of the potential tobacco tax loss in Fiscal Year 1973 due to the exemptions of cigarettes sold by military stores. The estimates of tobacco tax loss exceed \$1 million in some 30 states and range up to \$19 million in Texas and \$22.6 million in California. Related to state tobacco tax collections, the ACIR figures constitute 9 percent or more of Fiscal Year 1973 collections in ten states and at least 5 percent in almost half of the states.

Of the states replying to the NTTA survey, nine states presented estimates of the revenue lost as a result of the exemption of cigarettes sold through military stores. These estimates were based mainly on regular printouts from manufacturers which show cigarettes shipped into the states, including a listing of tax-free sales to military stores (not all states receive these reports). The state estimates were about \$1 million or more in each case and ranged up to \$19.5 million in Florida and \$21 million in California. Related to cigarette tax collections, they ranged up to 11 percent in Florida, 9 percent in Kansas, 8 percent in California, 6.5 percent in Rhode Island, and 5.5 percent in Nebraska. Alaska reported that the estimated cigarette tax revenue loss was 18.4 percent of cigarette shipments into the state. Virginia estimated that 10 percent of gross cigarette sales were exempt sales by military stores.

The statistics relating estimated tax loss suggest that, if military store sales of cigarettes were not exempt, the state tax rate could be reduced one cent or more in many states and still produce the same amount of revenue.

Tax Evasion

The state tobacco tax administrators report that while there are relatively few instances in which individuals have been apprehended abusing the military cigarette exemption privilege, there is a general recognition that tax evasion is sizable. As previously noted, the disparate per capita consumption figures, coupled with the easy opportunity of evasion, are the primary evidence that evasion is taking place.

The fact that there have been relatively few instances where individuals have been apprehended selling exempt military cigarettes can be attributed to the fact that there is no readily available means for tracking down instances of the abuse of the exemption. It is a simple thing for an authorized person to purchase cigarettes for friends. And, while collectively such purchases involve large amounts of revenue, individually the amount of revenue is small, and the instances are so numerous that an organized enforcement effort is just not practical.

The replies, however, do cite a number of instances in which the illicit sale of military exempt cigarettes was involved. Some of them are as follows: In Hawaii, post exchanges were selling tax-free cigarettes to civilians. The practice ceased on complaint from the state tax department. However, the military agencies continued to sell tax-free cigarettes through vending machines available to anyone.

Michigan reports that there have been numerous instances of retired persons buying cigarettes at an Air Force base in quantities and disposing of them by sales to civilian friends. The Michigan tax administrator suggests that if the current exemption of on-base sales were retained, a strong case could be made for terminating the exemption for retired military personnel. These persons live in a civilian community and have a ready market for the tax-free cigarettes they may obtain from military stores.

Pennsylvania reports the arrest of persons selling and possessing unstamped cigarettes obtained from military installations. Washington reports the following instances: 1) a soldier paying his rent in tax-free cigarettes; 2) a retired sergeant major selling cigarettes purchased from a commissary for a vending machine which he owned; and 3) the sale of commissary purchased cigarettes at a garage sale.

Alabama reports apprehending a large number of persons selling cigarettes obtained from military bases. Further, it found inadequate monitoring of controls by Army agencies and instances where individuals were permitted to purchase repeatedly quantities of cigarettes far in excess of normal needs. Its administrator concluded that the only solution to this problem was the elimination of the exemption by amending the *Buck Act*.

Summary

In summary, the replies to the NTTA survey describe a situation in which badly needed state revenue is lost as a result of an exemption system whose original purpose may no longer be valid. More than that, the replies indicate the exemption creates enforcement problems which are exceedingly difficult to cope with, and there is a need for a substantial enforcement effort which at best could have dubious results, or in its place, tacit acceptance of a continuous loss of revenue through illicit transactions arising from the abuse of the military exemption privilege.

Statement Submitted (Not Presented) by the American Logistics Association*

The American Logistics Association (ALA) would like to go on record as opposing any imposition of state-county-municipal excise or sales tax on items sold by military commissary stores, exchanges, clubs or other resale outlets located on Federal installations.

The Association feels first, that imposition of such taxes on military resale patrons would be grossly unfair, since the members of such a specialized "customer population" would not be likely to receive any benefit from—or any voice in—the use of funds collected by such taxes.

Second, the Association feels that, in the case of the commissary stores, the imposition of the taxes under consideration could be illegal. They could have the effect of increasing surcharges presently being collected by the commissaries to pay for certain operating expenses. We believe only Congress has the authority to permit raising or changing the surcharge structure.

(Earlier this year, the Administration and the Department of Defense recommended that surcharges be increased to pay the salaries of commissary store employees. The U.S. House of Representatives on July 31, 1975, rejected those recommendations by overwhelmingly passing (364-53) H. Con. Res. 198, which expresses opposition of the Congress to any change in the present method of providing financial support for military commissaries through appropriations to meet their payroll costs. The concurrent resolution, expressing a "sense of the Congress," is presently awaiting action by the U.S. Senate. Should it be passed by that legislative body, the President has no veto power.)

In short, the ALA believes that the present Congress is in no mood for any erosion of commissary store benefits for active duty and retired military persons and their dependents.

The Association further feels that if the taxes were imposed on the sales of exchanges and other resale activities, they would have to take the form(s) of increased markups. Such increases would simply help to defeat the purpose of these operations.

Another indication of negative attitude toward such tax impositions came on June 2, 1975, when the U.S. Supreme Court decided in favor of the United States, which had protested—and paid under protest—a "wholesale markup" on liquor sold at government installations in the State of Mississippi. We particularly commend ACIR to the fourth section of that decision.

ALA members believe that the ACIR commentary regarding alleged "bootlegging" of cigarettes by service personnel is not only degrading, but also demonstrates lack of knowledge and/or incomplete research. Several studies have been made regarding the per capita use of cigarettes by military personnel, and these concur in the conclusion that military members do, in fact, smoke more than their civilian counterparts. One example of such a study, *British Soldiers' Smoking Habits*, says, in part: ". . . Of the soldiers, 75 percent were regular smokers and 94 percent of the regular smokers were exclusive smokers of cigarettes. More than two-thirds of the cigarette smokers consumed more than 20 a day and more than a quarter smoked more than 25 a day. Both the proportion of regular smokers and the numbers of cigarettes smoked are in excess of the national average. No evidence could be found to suggest a decrease in smoking akin to that reported for similar age groups in the United Kingdom as a whole during the period"

The ALA would be happy to provide ACIR's staff with this and other study materials on service smoking consumption.

Apparently the ACIR staff believes that military shoppers' food-buying patterns are the same as those in civilian life. Not so, we suggest. To clarify this, we recommend that ACIR members visit any conveniently located commissary store on a military payday. Military shoppers visit their commissaries once every other week—after they've been paid. They stock up on everything they can for the coming two weeks; they buy—or try to—enough meat, milk, frozen food, produce, etc., to last until their next

*The American Logistics Association, formerly the Quartermaster Association and the Defense Supply Association, is a national trade association which has its main purpose the promotion of activities, interest, and objectives of firms and individuals actively engaged in the manufacture, sale, and distribution of products and services to agencies of the United States government.

payday. If an individual soldier or airman purchases his entire allotment of cigarettes, and that of his spouse, then what rule has been broken? Those smokes have to last throughout the pay period.

As for the "bootlegging," the ALA was told by the Council Against Cigarette Bootlegging, "It's miniscule. The servicemen don't make a ripple on the waters of real-life cigarette bootlegging." We recommend to ACIR's attention a case study by that group on bootlegging by organized crime so that ACIR may acquaint itself with a *bona fide* area of interest in intergovernmental relations.

In pointing out that military retirees "come out" between the ages of 40 and 45 years, and that many of them have "second incomes," the ACIR report dutifully omits mentioning that these persons pay all taxes associated with civilian life—on their retirement pay and on their "second income" earnings. Persons retiring at age 65 pay no tax thereon.

There are two other significant differences between military retirees and their civilian counterparts. First, because of the generally younger ages of military retirees, they tend to "still have families." Older civilians most likely have seen their offspring grow into the world. The other difference is simple: Name the civilian retiree who must return to active duty in the event of national emergency.

One last note for ACIR consideration: Active duty military personnel paid about \$5 billion in Federal income tax during Fiscal Year 1975, and the income tax paid to the Federal government by retirees came to some \$1.7 billion. If any state, county or municipal economy has been "disturbed" by the presence of military resale operations—which we doubt—then we suggest that "compensation" has already been made in the form of various revenue sharing programs.

Appendix D

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**

November 19, 1975

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.

¹Whenever 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, etc., 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.

We have reviewed three bills introduced in the first 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.

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-4³ be used to obtain a declaration of legal residence (see chapter 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 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.

	Number	Percent
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.

	Number	Percent
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.

	Number	Percent
Responses sampled:		
Claimed state which exempted service pay or had no individual 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, eight of the 19 non-filing cases involved states which do not exempt military pay outright but provide that under certain conditions legal-resident military personnel will be

granted non-residency 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.

Two other cases of apparent non-compliance 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 non-filers 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 Administrators⁴ 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) non-compliance with state income tax filing requirements is widespread among members of the Armed Forces, (2) this non-compliance 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.

¹On September 25, 1975, the Office of Management and Budget rescinded A-38.

²Statement of earnings and tax withholdings.

³Employees' withholding exemption certificate.

⁴The 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.

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) non-residents 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 ^a	Michigan ^a
Arizona ^b	Minnesota ^b
Arkansas ^b	North Dakota ^b
California ^c	Oklahoma ^b
Idaho ^d	Oregon ^b
Illinois ^a	Pennsylvania ^d
Indiana ^b	Vermont ^a
Iowa ^a	West Virginia ^b
	Wisconsin ^b

States Not Having Individual Income Tax (10)

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

In ten 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 four of the 24 states which do not exempt any military pay and in two of the ten states with partial pay exemptions, residency definitions provide legal-resident military personnel non-residency 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.

^aAll service pay exempted.

^bPartially exempted.

^cExempted in full if stationed outside state; partially exempted if stationed within state.

^dExempted in full if stationed outside state; taxable in full if stationed within state.

^eTax on capital gains.

^fTax on interest and dividends.

^gTax on interest and dividends and commuter tax.

^hNew York commuter tax and surcharge.

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 Relations¹ 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.

¹A 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 reexamination 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. 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 two 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.

SELECTED ACIR PUBLIC FINANCE REPORTS

- The Role of the States in Strengthening the Property Tax*, A Commission Report A-17, (Washington, D.C.: Government Printing Office, Revised 1976), Vol. I, 187 pp.
- State-Local Taxation and Industrial Location*, A Commission Report A-30, (Washington, D.C.: Government Printing Office, April 1967), 114 pp.
- Fiscal Balance in the American Federal System*, A Commission Report A-31, (Washington, D.C.: Government Printing Office, October 1967), Vol. I, 355 pp.
- Fiscal Balance in the American Federal System—Metropolitan Fiscal Disparities*, A Commission Report A-31, (Washington, D.C.: Government Printing Office, October 1967), Vol. II, 393 pp.
- State Aid To Local Government*, A Commission Report A-34, (Springfield, Virginia: National Technical Information Service, April 1969), 105 pp.
- Urban America and the Federal System*, Commission Findings and Proposals M-47, (Springfield, Virginia: National Technical Information Service, October 1969), 140 pp.
- Federal Approaches To Aid State and Local Capital Financing*, A Commission Report A-37, (Washington, D.C.: Government Printing Office, September 1970), 71 pp.
- Revenue Sharing—An Idea Whose Time Has Come*, An Information Report M-54, (Washington, D.C.: Government Printing Office, December 1970), 29 pp.
- Measuring the Fiscal Capacity and Effort of State and Local Areas*, An Information Report M-58, (Washington, D.C.: Government Printing Office, March 1971), 209 pp.
- Financing Schools and Property Tax Relief—A State Responsibility*, A Commission Report A-40, (Washington, D.C.: Government Printing Office, January 1973), 261 pp.
- City Financial Emergencies: The Intergovernmental Dimension*, A Commission Report A-42, (Washington, D.C.: Government Printing Office, July 1973), 186 pp.
- The Value-Added Tax and Alternative Sources of Federal Revenue*, An Information Report M-78, (Washington, D.C.: Government Printing Office, August 1973), 86 pp.
- The Expenditure Tax: Concept, Administration and Possible Applications*, An Information Report M-84, (Washington, D.C.: Government Printing Office, March 1974), 56 pp.
- Local Revenue Diversification: Income, Sales Taxes & User Charges*, A Commission Report A-47, (Washington, D.C.: Government Printing Office, October 1974), 85 pp.
- General Revenue Sharing: An ACIR Re-evaluation*, A Commission Report A-48, (Washington, D.C.: Government Printing Office, October 1974), 65 pp.
- The Property Tax in a Changing Environment*, An Information Report M-83, (Washington, D.C.: Government Printing Office, March 1974), 297 pp.
- Property Tax Circuit-Breakers: Current Status and Policy Issues*, An Information Report M-87, (Washington, D.C.: Government Printing Office, February 1975), 40 pp.
- Federal-State-Local Finances: Significant Features of Fiscal Federalism*, An Information Report M-79, (Washington, D.C.: Government Printing Office, February 1974), 344 pp.
- ACIR State Legislative Program*, Part 3, State and Local Revenue (M-94) and Part 4, Fiscal and Personnel Management (M-95), (Washington, D.C.: Government Printing Office, November 1975).
- Understanding the Market for State and Local Debt*, An Information Report M-104, (Washington, D.C.: Government Printing Office, May 1976), 56 pp.



what is acir?

The Advisory Commission on Intergovernmental Relations (ACIR) was created by the Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of Federal, state, and local government and the public.

The Commission is composed of 26 members—nine representing the Federal government, 14 representing state and local government, and three representing the public. The President appoints 20—three private citizens and three Federal executive officials directly and four governors, three state legislators, four mayors, and three elected county officials from slates nominated by the National Governors' Conference, the Council of State Governments, the National League of Cities/U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Congressmen by the Speaker of the House.

Each Commission member serves a two year term and may be reappointed.

As a continuing body, the Commission approaches its work by addressing itself to specific issues and problems, the resolution of which would produce improved cooperation among the levels of government and more effective functioning of the federal system. In addition to dealing with the all important functional and structural relationships among the various governments, the Commission has also extensively studied critical stresses currently being placed on traditional governmental taxing practices. One of the long range efforts of the Commission has been to seek ways to improve Federal, state, and local governmental taxing practices and policies to achieve equitable allocation of resources, increased efficiency in collection and administration, and reduced compliance burdens upon the taxpayers.

Studies undertaken by the Commission have dealt with subjects as diverse as transportation and as specific as state taxation of out-of-state depositories; as wide ranging as substate regionalism to the more specialized issue of local revenue diversification. In selecting items for the work program, the Commission considers the relative importance and urgency of the problem, its manageability from the point of view of finances and staff available to ACIR and the extent to which the Commission can make a fruitful contribution toward the solution of the problem.

After selecting specific intergovernmental issues for investigation, ACIR follows a multistep procedure that assures review and comment by representatives of all points of view, all affected levels of government, technical experts, and interested groups. The Commission then debates each issue and formulates its policy position. Commission findings and recommendations are published and draft bills and executive orders developed to assist in implementing ACIR policies.

