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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT DIVISION

B-217850

APRIL 11, 1985

The Honorable Daniel J. Evans
United States Senate

The Honorable Slade Gorton
United States Senate

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Subject: State Income Taxation of Nonresident Railroad Employees (GAO/GGD-85-46)

On September 27, 1984, representatives from your offices met with members of my staff to discuss legislation that you were considering introducing. This legislation would prohibit a state from taxing the wages of railroad employees domiciled outside the state ("nonresident employees") if the employees earned less than half of their annual compensation within the state. Your representatives asked us to determine whether sufficient data were available to analyze in detail the effects of the proposed federal restriction on state revenues. In particular, your representatives were interested in knowing how much revenue each state would lose if the legislation were enacted. We agreed to survey revenue officials of a number of states and payroll officers of several major railroads to determine whether either the states or the railroads maintained adequate data to measure the revenue effects of the proposed restriction.

We conducted our survey by telephone in October 1984 and briefed your representatives on the results in November 1984. The results showed that adequate data are not available to measure the revenue effects of the proposed restriction. This report, provided at your representatives' request, summarizes what we learned during our survey.

Many states tax wages earned within their borders by both residents and nonresidents. Like the federal government, they rely on employers to withhold income taxes from wages for efficient tax administration. However, in the case of railroad employees, federal law restricts what states may require railroad companies to do. Public Law 91-569 requires railroad companies to withhold taxes only for the state in which the employee earns more than half of his or her total compensation, if the employee earns more than half in one state. The law requires the company to report wage and withholding information to that state and to the employee's state of residence, if different. Other states may not require the company to withhold tax from those employees' wages.

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For employees who earn more than half, but not all, of their total compensation in their home state or who do not earn as much as half of their total compensation in any one state, the law requires the company to withhold income tax for, and file information returns with, the employee's state of residence and no other state. Thus, if an employee earns less than half of his or her total compensation in a state other than the employee's home state, only the revenue department in the employee's home state receives information about the employee's railroad earnings. Other states in which such employees may have worked cannot require the railroads to provide wage and withholding data on these employees.

We would need detailed employment, compensation, and tax data for railroad employees to estimate the effects of a federal limitation on the states' powers to tax the wages of nonresident railroad employees. We questioned financial officers of seven major railroads and revenue officials of nine states to determine whether either the railroads or the states collect and maintain such data. The railroads we surveyed were Amtrak, Burlington Northern, Conrail, Santa Fe, Seaboard, Southern Pacific, and Union Pacific. We selected them because they are large companies with lines that pass through many states. We called revenue officials in Georgia, Idaho, Louisiana, Missouri, Montana, Nebraska, New Mexico, Oregon, and Wisconsin. We selected these states because they impose a state income tax and are crossed by one or more of the railroads that we surveyed.

We asked railroad officials whether their companies maintained for every employee a record of the number of miles traveled in each state, the length of time spent working in each state, or the compensation received for work performed in each state. If a company's payroll, tax, or management information systems contained these data, we asked whether officials regularly reported the information to the states in which they operated. We also asked what arrangements were made for the withholding of state income taxes from employees' wages. We asked state revenue officials whether the department of revenue could identify nonresident railroad employees who earned less than half of their total annual compensation within the state. If they replied that it could, we asked how it did so, how many nonresidents worked in and paid taxes to the state, which railroads they worked for, and how much tax the state collected from them.

We found that the data needed to analyze the effects of the proposed restriction on tax collections are not generally available. Only one of the railroads that we surveyed, the Burlington

Northern, has a payroll system that allows management to track the miles traveled, time spent, or compensation earned in each state by each employee. Similarly, of the states surveyed, only Idaho and Montana attempt to identify nonresident railroad employees who work within their borders in order to tax the employees' within-state earnings.

According to the railroad officials with whom we spoke, these railroads depend upon the employees to identify the state for which income taxes should be withheld. Each year, the companies ask those employees who may work in more than one state to complete a form declaring whether they expect to earn more than half of their total compensation that year in a single state that is not their state of residence. The railroads then base the withholding of state income taxes and reporting of wages on these declarations. Of the railroads we surveyed, only the Burlington Northern maintains such employee-specific data as miles traveled, time spent, or compensation earned in each state by each employee. The other railroads that we surveyed suggested that they had little need for such detailed records. We were told that they neither collect nor maintain this information and thus cannot provide it to any state.

Most of the state officials with whom we spoke acknowledged that, without the kind of information discussed above, their revenue departments cannot readily identify how many nonresident railroad employees are paying taxes, how much they are paying, or whether they are paying the correct amount. Similarly, we were told that most departments do not know how many nonresident railroad employees should be paying taxes but are not. According to these officials, most states rely on voluntary self-assessment by nonresident railroad employees for whatever tax they collect on those employees' earnings.

On the basis of this information, we concluded that adequate data were not available to evaluate the revenue impact of limiting the power of states to tax nonresident railroad employees. If you have any questions or wish to discuss this matter further, please contact Johnny C. Finch at 275-6407.

W. J. Anderson

William J. Anderson
Director