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REPORT BY THE U.S.

General Accounting Office

Delays In Receiving And Investing Taxes Are Reducing Railroad Retirement Program Interest Income.

24 Sep 81

Under the railroad retirement program, employers are required to deposit retirement taxes monthly, instead of semimonthly, biweekly, or even more frequently as is the case for social security taxes. In fiscal year 1980, the railroad retirement program could have earned about $25.9 million in additional interest income if railroad employers were required to deposit retirement taxes as frequently as other employers deposit social security taxes and such taxes began earning interest as soon as collected.

The Secretary of the Treasury should require more frequent deposit of railroad retirement taxes. Also, Treasury and the Railroad Retirement Board should look into ways to reduce delays in investing railroad retirement taxes to increase the railroad retirement program's interest income.

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GAO/HRD-81-112
SEPTEMBER 24, 1981

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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

HUMAN RESOURCES DIVISION

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The Honorable James J. Florio
Chairman, Subcommittee on Commerce,
Transportation, and Tourism
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

Earlier this year, we advised your staff that the Railroad Retirement Board could earn additional interest income for its retirement program if railroad employers were required to make more frequent deposits of retirement tax contributions and such contributions were transferred quicker from the Department of the Treasury to the Board. The additional income would result from the tax contributions being available to the Board for earlier investment. This report summarizes our findings and conclusions.

If Treasury's requirements for the deposit of railroad retirement taxes had been the same as those for the deposit of social security taxes by nonrailroad employers covered under social security, the Board, in fiscal year 1980, could have earned additional interest income of at least $18.9 million for its retirement program. 1/ Also, the Board could have earned about $7 million in additional interest income for that year if railroad employers' retirement tax contributions had been invested within 1 day after deposit rather than the 6 to 14 calendar days it now takes to invest these funds. In total, more frequent deposit and quicker transfer of retirement tax contributions could have earned the Board about $25.9 million in additional interest income in fiscal year 1980. The amount of additional interest income gained in the future by requiring such changes will vary depending on the contribution rate, contribution base, the prevailing interest rate, and the actual dates of deposit.

1/In this report, the term "nonrailroad employers" pertains to private employers and does not include State and local governments.

HRD-81-112

For the Board to earn additional income from more frequent deposits of retirement tax contributions, Treasury's regulations for collecting such taxes would have to be amended. Amending the regulations to place railroad employers on the same tax deposit timetable as nonrailroad employers would also have the effect of placing railroad retirement tax deposits on the same basis as currently required of railroad and nonrailroad employers for deposit of withheld Federal income taxes. Because of the retirement program's financial problems over the years, we believe that such a change is justified because it would maximize the Board's interest income and improve its cash flow while placing railroad employers on the same deposit timetable as nonrailroad employers.

Additional interest income could also be earned for the Railroad Retirement Account (hereafter referred to as Account) if the Board and Treasury work together to speed the transfers of collected railroad employers' tax contributions to the Board for earlier investment. To accomplish this objective, the Board, except for the management member, believes that Treasury should require railroad employers to use the Treasury Financial Communication System (TFCS)--a computer-assisted deposit system which transfers funds electronically within 1 day--for depositing tax contributions. Treasury agrees that the Board should earn the additional interest income that would derive from quicker transfers of funds, but objects to requiring mandatory use of the TFCS for railroad employers because of certain problems it could cause in processing tax contributions. Treasury believes that another alternative may exist to earn the additional interest income for the Board. We believe that Treasury, in cooperation with the Board, should decide how best to ensure that the Account will earn interest from railroad retirement tax contributions as soon as they are deposited.

OBJECTIVE, SCOPE, AND METHODOLOGY

In recent years the financial stability of the Account has been seriously impaired. The Board predicts that it may not be able to pay total benefits by 1982. Because of this, we sought to determine how more timely tax deposits could improve the program's cash flow. Since this study began, the Congress has passed the Omnibus Budget Reconciliation Act of 1981 which contains provisions dealing with railroad retirement's financial problems. We have examined these provisions and found that they did not include the matters discussed in this report. Even if the legislative provisions improve the financial outlook for the Account, we believe that it is in the best interest of the program to maximize interest earnings to the Account.

Our work was conducted primarily at the Board's headquarters in Chicago, Illinois. We reviewed the legislative history of certain sections of the Railroad Retirement Act, as amended; interviewed officials of the Board, the Treasury, and the Internal Revenue Service (IRS); interviewed representatives of several railroads selected at random; and reviewed and analyzed pertinent agency records. The Board, Treasury, and the Association of American Railroads (AAR) reviewed and commented in writing on a draft of this report. 1/ We incorporated their comments where appropriate and the text of each agency's comments is in appendixes I through III.

In estimating the additional interest income which could have been earned with more frequent deposit requirements, we used the taxable payroll totals railroads reported to the Board and applied the appropriate tax rates to determine payroll taxes paid for fiscal years 1978-80. To these taxes, we applied an average of the interest rates applicable during the 1978-80 period to the additional investment days that the Board would have had for that period if railroad employers' deposit requirements were the same as those for nonrailroad private employers covered by social security. Although many State and local governments are covered by social security, their deposit requirements are different from those for private employers. In 1978, we reported to the Congress on the opportunity for the social security trust funds to realize additional interest income if State and local governments deposited social security taxes more frequently. 2/

We estimated the additional investment days the Board would have had by calculating the difference between the current deposit requirements for railroads and deposits made twice a month within 3 banking days after the close of the deposit period. Most railroads pay employees biweekly or semimonthly and have tax liabilities which, if covered by the current deposit requirements for nonrailroad private employers, would require deposit within 3 banking days after the close of the deposit period. The actual payroll date varies among railroads, but generally the earlier in the month it occurs the greater the opportunities for additional interest through more frequent deposits. Our estimates, shown on page 7, are based on payrolls being paid the 15th and the last day of each month and hence are conservative. For example, if an estimate were

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1/The Association of American Railroads is a trade organization which represents the interest of large railroads (Class I).

2/"Liberal Deposit Requirements of States' Social Security Contributions Adversely Affected Trust Funds" (HRD-79-14, Dec. 18, 1978).

made on the basis of payrolls on the 1st and 15th of each month, the estimated additional interest for fiscal year 1980 would be about $9.4 million more.

Although railroad employers, as discussed below, pay taxes for the retirement program in excess of the social security contribution of nonrailroad employers, we did not attempt to separate what the interest would be on the amount of tax that would be equivalent to social security withholding. While railroads could incur some additional administrative costs by depositing taxes more frequently and could be adversely affected by losing the interest they now earn by holding tax deposits longer, we did not attempt to measure these financial effects.

The estimate of additional interest income that could be earned by the Board if railroad employers' retirement tax deposits were transferred to the Account within 1 day after receipt by Treasury was developed by the Board's internal auditors. The estimate was based on the elapsed time for the first 3 months of 1980, from the date taxes were due to the date Treasury notified the Board of the availability of funds, and it was calculated using an interest rate of 9.5 percent. Because actual interest rates in 1980 were somewhat higher (the average was 11 percent), the Board's estimate appears conservative. For this study, we did not recompute or review the accuracy of the Board's computations, however, our review of records for the first 3 months of 1981 indicated that the elapsed time was similar to that as measured by the Board.

FUNDING THE RAILROAD RETIREMENT PROGRAM

The railroad retirement program began in 1935 as a staff retirement plan exempt from social security coverage. It provided benefits to retired railroad workers only. Employers' and employees' payroll taxes funded the program with no Federal assistance until 1951. In 1951, the Congress enacted legislation that provided for a financial interchange between the social security and railroad retirement systems based on the principle that the social security trust funds should neither gain nor lose because of the separate existence of the railroad retirement system. The interchange requires that the Secretary of the Department of Health and Human Services and the Board determine what the Social Security Administration would have paid to railroad beneficiaries if they were covered by social security. If this amount exceeds the taxes received by railroad retirement for such benefits, social security must transfer the difference to the Board. If railroad retirement receives more in such taxes than what is needed to pay railroad beneficiaries what they would have received under social

security, the Board transfers the excess to social security. As a result of the interchange and the Railroad Retirement Act of 1974, railroad retirement benefits now consist of a portion (tier I) which is the equivalent of a social security benefit and a second portion (tier II) which is comparable to a private pension.

To finance railroad retirement's equivalent of the social security benefits, railroad employees pay the same tax rate as workers under social security--in 1981, 6.65 percent on earnings up to $29,700 a year. Railroad employers, like social security employers, match the retirement taxes their employees pay. 1/ Railroads also pay additional retirement taxes of 9.5 percent on employees' earnings up to $22,200 a year for the private pension portion of the retirement benefits. (After Sept. 30, 1981, the tax rate for employers will increase to 11.75 percent and a new tax of 2 percent will be imposed on employees.) In addition, railroad employers pay a separate $0.145 for each employee-hour worked to finance a supplemental benefit. Contributions for the social security and private pension portions of the benefits are combined in the Account at Treasury. 2/

Funds in the Account are invested in interest-bearing government securities. Before 1974, the Secretary of the Treasury managed the accounts' investments for the Board. The Railroad Retirement Act of 1974 gave the Board the authority to invest and manage its own accounts. For fiscal year 1979, the Board earned about $187 million in interest for the Account.

THE RAILROAD RETIREMENT PROGRAM CAN EARN ADDITIONAL INTEREST INCOME

The Account could have earned about $44.2 million in additional interest income for fiscal years 1978-80. This interest was not realized because Treasury regulations allow railroad employers to make fewer deposits of retirement contributions than nonrailroad employers. If railroad employers had made deposits semimonthly or biweekly or even more frequently depending on the amounts involved,

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1/Taxes for railroad workers and employers are applied to monthly rather than yearly maximum taxable earnings as is done under social security. Consequently, taxes under each program might vary slightly.

2/ Employers' contributions for supplemental benefits are maintained in an account in Treasury separate from the Railroad Retirement Account.

instead of monthly, the money would have been available for earlier investment to earn additional interest. For fiscal year 1980, semimonthly or biweekly deposits could have earned the Account $18.9 million in additional interest income. The amount of additional interest that could be earned each year will vary depending on the contribution rate, contribution base, the prevailing interest rate, and actual dates of deposit.

Treasury could require more frequent retirement tax deposits

The Secretary of the Treasury, through IRS, establishes requirements for depositing withheld Federal income taxes and retirement tax contributions for both the social security and railroad retirement programs. Although railroads and nonrailroads have the same deposit requirement for withheld Federal income taxes, their retirement contribution requirements differ significantly. Treasury requires nonrailroad employers to deposit social security contributions more frequently than railroad employers are required to deposit retirement contributions.

For nonrailroad employers, the deposit requirement for social security contributions and withheld Federal income taxes vary depending on the amount of taxes due from an employer. To arrive at these amounts, social security contributions and withheld Federal income taxes are combined. Beginning in January 1981, whenever the combined tax liability for an employer is less than $500 at the end of a calendar quarter, the employer must pay the accumulated taxes by the end of the following month. If the liability is more than $500, but less than $3,000 at the end of any month, the taxes must be deposited by the 15th of the following month. Whenever the accumulated tax liability exceeds $3,000, a deposit must be made within 3 banking days after which one of the following days comes next--the 3rd, 7th, 11th, 15th, 19th, 22nd, 25th, or last day of the month. The 1981 deposit requirements are more stringent than prior regulations in that the larger accumulated amounts (over $3,000) require up to eight deposits a month rather than the four deposits required by previous regulations. The more stringent requirements were the results of the President's Cash Management Project to improve the Government cash flow through more timely collection of tax receipts. While rail industry employers do not pay social security taxes, they must comply with these deposit requirements for withheld income taxes.

However, fewer deposits of retirement contributions are required for railroad employers. For any month in which railroad employer and employee retirement contributions exceed $100, deposits must be made

--within 15 days after the close of the month for the first 2 months of a quarter and

--by the end of the month following the last month of a quarter.

For example, contributions received from wages paid in January must be deposited by February 15, in February by March 15, and in March by April 30.

According to Treasury, the deposit regulations for railroad retirement contributions are similar to those for social security and income tax withholding before 1967. It appears that, while Treasury has periodically changed the regulations for deposit of social security contributions and withheld Federal income taxes, deposit requirements for railroad retirement contributions were not changed. Treasury and IRS officials said that they did not know why the regulations for railroad retirement contributions have not been changed to match social security's, but believed that it could have been because either the amount of the taxes was small in relation to other tax collections or the issues were overlooked.

More frequent retirement tax deposits could provide additional interest income

If railroad employers had made retirement tax deposits at least twice a month within 3 banking days after the close of the deposit period in which the payroll is paid instead of monthly, the Account could have earned an estimated additional $44.2 million in interest income for fiscal years 1978-80.

Year	Amount (millions)
1978	$10.7
1979	14.6
1980	18.9
Total	$44.2

Although some railroad employers pay employees weekly, most pay employees semimonthly or biweekly. If railroad employers were required to deposit retirement contributions in accordance with the requirements for social security contributions and withheld Federal income taxes, railroad employers retirement deposits would generally have to be made twice a month within 3 banking days after

the deposit period in which wages are paid. The more frequent deposits would help improve the Account's cash flow and result in funds being available to the Board for earlier investment to earn additional interest for the Account.

IRS officials said that to change the deposit requirement administratively could take as long as a year if handled routinely. Such a change, they said, would involve (1) issuing proposed regulations, (2) evaluating responses, and (3) holding hearings, if necessary. They also told us that if more frequent deposits of railroad retirement contributions were required, there would be no significant burden on the IRS' workload.

In its comments on a draft of this report, Treasury stated that it is appropriate for railroad retirement tax payments to be made on the same schedule as those for withheld income and social security taxes. However, Treasury believes that the Board should request Treasury to change the deposit requirements because the Board is responsible for the Account.

FASTER TRANSFER OF RETIREMENT CONTRIBUTIONS COULD INCREASE THE BOARD'S INTEREST INCOME

Estimates by the Board's internal auditors indicate that the Account could have earned at least $7 million in additional interest income in fiscal year 1980 if railroad retirement taxes were available to the Board for investment 1 day after deposited. Under the current system, it takes about 6 to 14 calendar days from the date the retirement taxes are due to the date that Treasury notifies the Board that the funds are available for investment. Because of this, interest earned on the taxes deposited accrue to Treasury rather than the Board during this period. Presently, there is uncertainty as to why the delay occurs. IRS officials advised us that IRS begins processing tax contributions 1 day after they are made and said that IRS payment centers take 4 working days to process payments and notify Treasury which then notifies the Board the next day. IRS officials questioned whether and why more than 6 days would elapse. As a result, IRS and the Board have agreed to review a sample of deposit payments to identify the cause and extent of the delay. Regardless of the cause and extent of the delay, we believe that the Board and Treasury should work together to seek a way to insure that railroad retirement can begin earning interest on the retirement tax deposits as soon as they are received by Treasury.

The Board believes that one way to maximize interest income would be for Treasury to require railroad employers to use the TFCS when they deposit retirement tax contributions. The TFCS

consists entirely of electronic transfers which could enable Treasury to notify the Board within 1 day that retirement payments are available for investment. 1/

Using the TFCS would not place an additional burden on railroad employers. It would require railroad employers to use a computerized deposit form when mailing or delivering their tax deposit to their bank. This would not affect the time the employer retains control of the funds because under either the current system or the TFCS the payments are charged to the employers' accounts not later than 1 day after receipt by the bank. The authority to require employers to use the TFCS rests with Treasury. Presently, Treasury does not require either railroad or nonrailroad employers to use this system. Officials of the Board told us that the Board is discussing with Treasury and IRS officials the feasibility of making use of the TFCS mandatory for railroad employers. At this time, both Treasury and IRS are opposed to changing the current system for processsing tax contributions.

IRS officials told us that they believe requiring railroad employers to use the TFCS would cause problems with the processing of retirement contribution payments. They said that because IRS does not handle any other tax payments over the TFCS, the processing of such payments would have to be done manually. They also said that the TFCS transmissions would not provide enough documentation to provide an adequate audit trail in cases of erroneous payments. They concluded that unless these problems are resolved, IRS could not support the use of the TFCS for railroad employers. We did not study the validity of IRS' problems with the TFCS or how such problems might be remedied.

Although Treasury supported IRS' position on the mandatory use of the TFCS, it believes that the Board should have an opportunity to maximize interest income. A Treasury official suggested that one alternative to TFCS would be more rapid allocation to the Board using estimated amounts based on when retirement contribution payments are due with later adjustments made after actual amounts have been determined. He said that before implementing such a system, however, some legal and operational matters would have to be examined.

1/The TFCS establishes a computer link between the Federal Reserve Bank of New York and commercial banks nationwide. Treasury developed the system as part of an overall program to improve cash management and financial reporting.

Another alternative, we believe, could involve having Treasury pay to the Account any interest Treasury earns on railroad retirement tax receipts before the time these funds are transferred to the Board. We did not assess the legality or feasibility of this alternative.

CONCLUSIONS

If the deposit requirements for the railroad retirement tax contributions were the same as those for social security, the Board could have earned an estimated additional $18.9 million in interest income for fiscal year 1980. In addition, about another $7 million could have been earned in fiscal year 1980 if the Account began earning interest on railroad employers' retirement tax deposits as soon as they were received by Treasury. The additional interest income which would have been earned for fiscal year 1980 thus totaled $25.9 million. The amount of additional interest income that could be earned in the future will depend on the contribution rate, contribution base, prevailing interest rates, and the actual dates of deposit.

Before 1967, the deposit regulations for railroad retirement contributions were similar to those for social security and income tax withholding. It appears that, while Treasury has periodically changed the regulations for deposit of social security contributions and withheld Federal income taxes to speed up collections, deposit requirements for railroad retirement contributions were not changed. Treasury officials stated that there appear to be no good reasons for different requirements and said that they do not know why the regulations for railroad retirement contributions have not been changed to match social security's.

Placing railroad retirement tax deposits on the same deposit timetable as social security tax deposits would place a greater burden on railroads than nonrailroads because railroads pay additional retirement taxes to finance the private pension portion of railroad retirement benefits. Similarly, because of special requirements for administering the railroad retirement program, railroads could incur some additional administrative costs in switching to more frequent deposits. We believe, however, that to the extent that the railroad retirement program provides benefits which go beyond that offered by social security, the railroads should be prepared to take actions which go beyond that required of nonrailroads.

Railroad retirement should earn interest on tax contributions as soon as they are received by Treasury. Using the TFCS could accomplish this. Other alternatives may exist. Treasury and the Board should examine the causes of delay in the current system,

identify what alternatives exist for prompt transfer of railroad retirement taxes, and decide how best to insure that the Account will earn interest on railroad retirement tax deposits as soon as possible after they are made.

AGENCY COMMENTS AND OUR EVALUATION

We requested and received comments on a draft of this report from the Board, Treasury, and AAR. Our draft report proposed that railroad retirement tax payments should be on the same schedule as those for nonrailroad employers' withheld income taxes and social security taxes and that the Account should earn interest on taxes as soon as the taxes are received by Treasury. Treasury and the Board generally agreed with our proposals. Treasury stated, however, that any change in the frequency of deposits should be initiated by the Board and might not be appropriate at this time because of pending congressional action to deal with the railroad retirement program's financial condition. AAR disagreed that railroad tax payments should be on the same schedule as those for nonrailroad employers. The full text of the agencies' and AAR's comments are in appendixes I through III and are discussed below.

Railroad Retirement Board

The Board, except for the management member, agreed with both of our proposals. The management member believes that the recommendations discussed in this report are matters that railroad management and labor should resolve. (See app. I.)

Department of the Treasury

Treasury agreed, in principle, that our recommendations are appropriate, but differed on how the enactment of an accelerated deposit schedule should be accomplished. Treasury said that if the Board requests accelerated deposits for railroad employers, Treasury would be inclined to act favorably upon it. However, Treasury noted that it may not be appropriate to change the current payment schedule because the Congress is considering the overall financial problems facing the Board.

We recognize that the Congress and others are examining ways to address the long-term financial problems of the railroad retirement program. However, the issue of whether railroads should have the same tax deposit schedule as nonrailroads seems to involve questions of equity and good cash management which can be addressed separately from any long-term solution. According to Treasury, there did not appear to have been any good reasons for allowing railroad retirement tax payments to lag behind those of other payroll taxes. Therefore, we believe that this matter could be addressed by Treasury issuing proposed regulations without awaiting

the results of congressional action on the overall financial problems of the Board.

Treasury also said that it opposed the use of the TFCS to speed transfer to the Board of railroad retirement taxes received, but said that it would explore the possibility of making more rapid allocation based on estimated payments. (See app. II.)

Association of American Railroads

AAR stated that it objected to our proposal to change the frequency of retirement tax deposits for railroads because

--it would place a disproportionate administrative burden on railroads,

--the financial difficulties of the railroad retirement fund should be addressed on a comprehensive, long-term basis, not by applying financial "band-aids," and

--changes in railroad retirement have traditionally been the subject of collective bargaining, and any change in the deposit requirements should continue in that tradition.

Regarding the administrative costs associated with accelerating the deposit schedule, AAR commented that although it was unable to calculate the costs at this time, the cost of programing and computer time to implement such a change would be significant. AAR seemed to attribute much of this additional cost to the railroads having to compute retirement tax contributions under different and more complex requirements than those of nonrailroad employers. For example, AAR said that railroad employers' and employees' contributions for the social security equivalent portion of the railroad retirement benefits are based on monthly maximum taxable earnings rather than annual earnings as those for employers and employees under social security. AAR also said that the contributions for the private pension portion also are based on a monthly wage limitation, but on a different maximum amount. In addition, employers pay a supplemental annuity tax based on employee staff hours. Because of this, AAR said that railroads' computation of retirement contributions is much more complex and costly than those for nonrailroad employers. AAR said that the different methods for computing taxes justify a deposit schedule for railroad taxes that is different from that used for nonrailroad taxes.

We agree that generally the administrative cost for railroad employers could be higher than those of nonrailroad employers if they both have the same deposit schedule. However, once the computer is reprogramed, it would appear that not much additional

computer time would be required because under either an annual or monthly maximum earnings base, with each payroll the computer would make the appropriate calculation. Furthermore, it is possible that placing railroad employers on the same tax deposit schedule as non-railroads could result in less of an administrative burden for railroads once the changes are reprogramed because payments would be made in conjunction with those currently made for withheld Federal income taxes.

In a previous report, 1/ we recommended to the Congress that railroad employers and employees be required to pay taxes for the social security equivalent benefits based on annual rather than monthly maximum taxable earnings. The Board estimated that for fiscal year 1978, it would have received $11 million more in railroad retirement taxes if the annual basis were used rather than the monthly. If the railroad retirement maximum earnings base is changed to an annual base, the transition to more frequent deposits could be facilitated. Meanwhile, under the present system, the railroad industry makes separate deposits of withheld Federal income taxes and retirement taxes and makes fewer deposits of relatively less social security equivalent taxes than nonrailroad employers.

AAR commented that the $28.5 million additional interest income from more frequent deposit and quicker transfer of retirement tax contributions "would not begin to make a dent in either the cash flow or actuarial problems of the fund." 2/ We believe that any additional funds coming into the Account would be a step in the right direction in dealing with long- and short-range financial problems. Furthermore, one of the provisions enacted by the Congress in the Economic Recovery Tax Act of 1981 increased the tax for the private pension portion from 9.5 to 11.75 percent for employers and initiated a 2-percent tax on employees. Consequently, more frequent deposit and quicker transfer of retirement tax contributions could provide amounts in excess of those stated in this report.

AAR stated that changes in railroad retirement have traditionally arisen from the collective bargaining process and proposals to the Congress for changes should not be made without first being considered in the collective bargaining context. AAR said that the congressional intent in the Railroad Retirement Act of 1974 was to

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1/"Keeping the Railroad Retirement Program On Track--Government and Railroads Should Clarify Roles and Responsibilities" (HRD-81-27, Mar. 9, 1981).

2/After AAR had received a draft of this report, we revised our estimate from $28.5 million to $25.9 million.

recognize tier II as a private pension type benefit which should require collective bargaining to enact future changes.

We recognize that matters involving the benefits and rates, especially for the private pension component, are negotiated through the collective bargaining process. However, the changes we are recommending do not require legislative action by the Congress and only involve the administration and processing of taxes after they are assessed with each payroll. Our proposals do not involve changes to the tax rate or base, but rather only changes in when taxes already assessed should be remitted. As such, we believe the changes we are proposing involve cash management issues which do not fall within the realm of collective bargaining. Moreover, we believe that the well being of the railroad retirement program goes beyond the mere interest of the railroad industry, in that the Congress appropriates funds to the program annually. The Congress provided railroad retirement about $1.4 billion for fiscal years 1976-80. Also, one of the provisions enacted by the Congress in the Omnibus Budget Reconciliation Act of 1981 provides the Board with limited authority to borrow funds from general revenues. Because of these and other considerations, we believe that the AAR's view that changes in the program should be made only through collective bargaining is unwarranted.

AAR also stated that more frequent deposits would cause the loss of almost $10 million to Treasury in taxable income. AAR reasoned that when railroads, instead of the Account, earn the additional interest income (estimated at $18.5 million for fiscal year 1980), this income is taxed at the corporate tax rate of 46 percent.

It would appear that AAR means that the interest that could be earned by the railroads by not accelerating the deposit schedule would be earned and declared, in all cases, as taxable income and that consequently any additional income realized by the Board would result in a loss to Treasury at 46 percent of that amount. We believe that not all such amounts held by the railroads would generate income, but that it depends on each railroad's financial status and operations as to whether such income would be earned and taxed. Regardless of the extent of any such offset, the result would be that the Account, the primary repository of the taxes collected, would receive the taxes sooner once they are collected and the Account, not Treasury or the railroads, would benefit from the interest earned.

AAR also said that the railroads are not opposed to pursuing use of the TFCS as a solution to the slow transfer of funds to the Board, but noted that the problem involved Treasury's ability to remit the funds on a timely basis and not whether the railroads used the TFCS. (See app. III.)

RECOMMENDATIONS

To realize additional interest income and improve the railroad retirement program's cash flow and financial condition, we recommend that:

--The Secretary of the Treasury direct IRS to require railroad employers to deposit railroad retirement taxes as frequently as nonrailroad employers are required to deposit social security taxes.

--The Secretary of the Treasury and the Board examine the causes of delay in transferring railroad retirement tax deposits from Treasury to the Account, identify what alternatives exist for prompt transfer of railroad retirement taxes to the Account, and decide the best way to insure that the Account will earn interest on the taxes as soon as they have been deposited with Treasury.

MATTER FOR CONSIDERATION
OF THE CHAIRMAN

Because (1) Treasury believes it may be inappropriate to change the current tax deposit requirements for railroads at a time when the Congress is considering the financial problems facing the railroad retirement program and (2) the railroad industry believes the frequency of retirement tax deposits should be the subject of collective bargaining, the Chairman may wish to advise Treasury whether it would be appropriate to initiate proposed rule changes.

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If you have any questions about the matters covered in this report, we would be pleased to discuss it with you. We are sending copies of this report to the Chairmen of the Senate Committee on Finance, the House Committee on Ways and Means, the Senate Committee on Labor and Human Resources, and the Joint Committee on Taxation; the Chairman of the Railroad Retirement Board; the Secretary of the Department of the Treasury; the Commissioner of Internal Revenue; and the Director of the Office of Management and Budget.

Sincerely yours,

Edward A Densmore

for Gregory J. Ahart
Director

UNITED STATES OF AMERICA
RAILROAD RETIREMENT BOARD
844 RUSH STREET
CHICAGO, ILLINOIS 60611

BOARD MEMBERS
WILLIAM P. ADAMS
C. J. CHAMBERLAIN
EARL OLIVER

Mr. Gregory J. Ahart, Director
Human Resources Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

We are pleased to comment on your draft report entitled, "More Frequent Deposit and Quicker Transfer of Retirement Tax Contributions Could Earn the Railroad Retirement Program Additional Interest Income."

Generally, the Board agrees with both of the report's recommendations. Regarding the first recommendation, interest income would significantly increase if the IRS required railroad employers to deposit railroad retirement taxes as frequently as non-railroad employers are required to deposit social security taxes. Regarding the second recommendation, the Board believes that increased interest income would be realized through the use of the Treasury Financial Communications System (TFCS). To be of maximum benefit, however, the use of TFCS should be mandatory, not just encouraged. If we were limited to merely trying to encourage railroad employers to use TFCS, likely only a few would do so. This has been our experience with the railroad unemployment and sickness insurance program. In October 1979, we obtained authority for railroad employers to deposit their contributions for this program by using TFCS. Because we merely encourage the use of TFCS and do not require its use, only 13 of 555 railroad employers use this method for depositing their contributions today. Accordingly, the Board is in favor of mandatory use of TFCS for this program and the railroad retirement program.

The Management Member of the Board, Mr. Earl Oliver, takes a different view. He does not believe that this is a matter on which the Board should take a position, rather that it is up to railroad management and labor to resolve the program's financing problems.

An important side benefit of using TFCS is that it would provide us with sufficient supporting documentation to account properly for the amounts shown on tax warrants. The present system does not provide us with this documentation. Accordingly, we are unable to reconcile taxes reported by railroad employers on their tax returns with deposit amounts shown on the tax warrants. Also, we are unable to ascertain whether monies recovered through IRS tax assessment audits have been properly credited to the Railroad Retirement Account. We believe that ensuring that the proper amounts have been deposited in the account is good, basic business practice and we would welcome assistance from GAO in pursuing this matter with the IRS.

GAO note: The page references in this appendix may not correspond to the page numbers in the final report.

On June 18, 1981, Board officials met with officials from the Bureau of Government Financial Operations (BGFO) and the Internal Revenue Service to discuss the Board's proposed use of TFCS for the railroad retirement program. BGFO officials were supportive of the proposal. IRS officials, however, expressed two concerns. One, that validity checks should be tested and in place before we begin using TFCS. And two, that IRS may not be able to commit staff to the development of this project for at least a year. Accordingly, we do not expect that proposed regulations for the use of TFCS will be prepared this year.

Finally, the following are three additional comments concerning information presented in the body of the report.

-- On page 4, you state that "...the Board's estimate appears conservative." It is, particularly in view of rising interest rates. Moreover, in estimating increased investment income, the Board's internal audit staff was intentionally conservative. This was constructive because it directed the discussion and decisionmaking toward the principle involved, not the dollar amount.

-- On page 5, you state that, "To add more categories of beneficiaries and help increase benefits, the Congress, in 1951, enacted legislation that provided for a financial interchange between social security and railroad retirement." It is clear from legislative history that the sole purpose and intent of the financial interchange is to place the social security trust funds in the same position they would have been had railroad employment been covered under the Social Security Act since its inception. Accordingly, we suggest the wording be changed to, "In 1951, the Congress enacted legislation that provided for a financial interchange between the railroad retirement and social security systems based on the principle that the social security trust funds should neither gain nor lose because of the separate existence of the railroad retirement system."

-- On page 11, you state that "...it takes approximately 8 to 14 calendar days from the time retirement taxes are deposited until Treasury transfers the funds to the Railroad Retirement Account and notifies the Board that the funds are available for investment." We suggest the wording be changed to "...it takes about 8 to 14 calendar days from the date retirement taxes are required to be deposited to the date Treasury deposits the taxes in the Railroad Retirement Account."

We appreciate your interest in improving the railroad retirement program's cash flow and financial condition.

Sincerely,

FOR THE BOARD
R. F. Butler, Secretary

APPENDIX II

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

Dear Mr. Ahart:

This letter contains the Treasury Department's comments on the draft General Accounting Office report, "More Frequent Deposit and Quicker Transfer of Retirement Tax Contributions Could Earn the Railroad Retirement Program Additional Interest Income."

The GAO report contains two separate recommendations, both of which are aimed at speeding up the receipt of RRTA taxes by the trust fund so that the fund would receive the benefit of additional interest income. The first recommendation is that employer deposits of RRTA taxes be accelerated to the same schedule applicable to employer deposits of withheld income and FICA taxes. The second recommendation is that once the Treasury Department receives the RRTA tax deposits, the funds should be transferred promptly from the general fund to the trust fund.

Prior to 1967, RRTA tax payments and payments of withheld income taxes and FICA taxes were made on the same schedule. Since 1967, payments of larger amounts of FICA taxes and withheld income taxes have been speeded up three times, but the schedule for RRTA tax payments has not been altered. There do not appear to have been any good reasons for allowing RRTA tax payments to lag behind those of other payroll taxes.

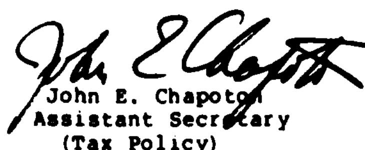
The Treasury Department believes that it is appropriate for RRTA tax payments to be on the same schedule as those of withheld income taxes and FICA taxes but that the initiative for this change should come from the Railroad Retirement Board. If such a request were received, the Treasury Department would be inclined to act favorably upon it. Because of the current financial problems facing the Railroad Retirement system, Congress will have to act in this area. In view of such Congressional consideration, it may not be appropriate to change the current payment rules.

The second GAO recommendation is that the Treasury Department allocate and pay the receipts to the trust fund more rapidly after they are received by the Treasury Department. The GAO report indicates that it may take as long as fifteen days for the transfers to occur once the funds are actually received by the Internal Revenue Service. IRS guidelines call for the transfers to be made within seven days, and IRS is investigating whether transfers are actually taking longer than seven days. If they are, IRS will take steps to eliminate the delay.

In an earlier version of this report, the GAO suggested that the allocation process could be speeded up if RRTA payments were transferred from the currently used Federal Tax Deposits (FTD) system to payment by wire transfer. Wire transfers actually speed up the collection of the funds by the government by less than one day, but use of wire transfers would make available almost immediately the records needed to make allocations to the trust fund. The Treasury Department opposes the use of a different and separate payment system for RRTA taxes. The FTD system works well, and the additional burdens on employers and on the Internal Revenue Service from the use of a second, parallel payment system are not justified. As an alternative to the use of wire transfer, the Treasury Department will explore the possibility of making more rapid allocations to the RRTA trust fund on the basis of estimated payments, with a periodic reconciliation later.

In addition to these specific comments, IRS and your staff have discussed and agreed upon many minor changes in the draft of your report. We assume that those changes will be incorporated in the final report. Thank you for giving the Treasury Department the opportunity to provide comments.

Sincerely,



John E. Chapoton
Assistant Secretary
(Tax Policy)

Mr. Gregory J. Ahart
Director
Human Resources Division
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

ASSOCIATION OF
AMERICAN RAILROADS
AMERICAN RAILROADS BUILDING WASHINGTON D C 20036

WILLIAM H. DEMPSEY
President and Chief Executive Officer

Mr. Gregory J. Ahart
Director
Human Resources Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

This letter constitutes the comments of the Association of American Railroads on the draft of your proposed report to the Chairman of the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee. The draft report proposes to improve the financial position of the Railroad Retirement program by requiring more frequent deposit and quicker transfer of Railroad Retirement tax contributions, and your letter, dated June 22, 1981, requested the comments of the AAR on that draft report.

The railroad industry objects to the changes proposed by GAO on three grounds. First, while GAO recognizes that railroads would incur additional administrative costs, GAO has underestimated the size of burden which would be placed on the railroads. Second, the financial difficulties of the Railroad Retirement Fund should be addressed on a comprehensive, long-term basis, not by applying financial "band-aids." Finally, changes in Railroad Retirement have traditionally been the subject of collective bargaining, and any change in the deposit requirements should continue in that tradition.

The GAO report states that a change in the deposit requirements would place railroad employers in the same position as non-railroad employers. Railroad Retirement taxes are not, however, comparable to FICA taxes, and so the accelerated deposit schedule would place a disproportionate administrative burden on the railroad employer vis-a-vis the FICA employer. The GAO report is comparing "apples and oranges" when it suggests placing RRTA and FICA deposits on the same timetable.

While it is difficult to determine precisely the additional administrative costs associated with accelerating the deposit schedule, it is not difficult to recognize the increased complexity which would give rise to those additional costs, particularly if

the supplemental annuity tax is included in the change. FICA taxes are computed by using an equal percentage for both the employer and employee tax (6.65% in 1981) applied to the annual wage base up to the annual wage limitation ($29,700 in 1981). The FICA employer can easily compute its FICA tax deposit liability by multiplying total wages by 13.3%. The only limitation facing a FICA employer is that the tax is no longer payable once the individual employee's wages exceed the wage limit for the year. Thereafter, that individual can be excluded from the FICA tax computation for the balance of the year.

The computation of RRTA taxes is much more complex. The RRTA is composed of a Tier I element (6.65% for both employer and employee on the first $2,475 of wages per month), a Tier II element (9.5% for the employer on the first $1,850 of wages per month), and the supplemental annuity tax ($0.145 per employee man-hour). The RRTA employer must constantly monitor wage payments to determine whether the Tier I or the Tier II wage base limitation has been exceeded. The present deposit schedule minimizes the expense of administration. While the employer must monitor the amount of the Tier I wages in order to compute the employee tax, the Tier II and supplemental annuity computation only have to be made once a month. Under an accelerated deposit schedule, these computations might have to be made up to eight times per month. The cost of the programming and computer time to implement such a change cannot be calculated with precision at this time, but it would be significant. Thus, the different methods for computing the taxes justify a deposit schedule for RRTA taxes different from that used for FICA taxes.

The railroads recognize, as does GAO, that the Railroad Retirement Fund is facing serious financial difficulties, both a near-term, cash flow shortfall and a longer-term actuarial deficit. The GAO report points out that more frequent deposit and quicker transfer of RRTA taxes would bring additional interest income to the Railroad Retirement Fund; the report estimates that the entire program of changes would have enabled the Fund to earn an additional $28.5 million in fiscal 1980. However, that amount of money would not begin to make a dent in either the cash flow or actuarial problems of the fund.

Any changes in the Railroad Retirement program, whether substantive or technical (as here), should be undertaken only in the context of a comprehensive solution to the financial problems of the Railroad Retirement Fund. The latest triennial valuation of the Railroad Retirement account indicates that there could be a long-term actuarial deficiency of from 0.65% to 4.61% of taxable payroll, depending upon the economic assumptions adopted. Moreover, there are short-term, cash flow problems which, it is estimated, will cause a shortfall of funds in early 1982. Because of the imminence of the cash flow problem, Congress enacted P.L. 96-582 on December 23, 1980, directing rail labor and management to agree upon a comprehensive solution to the Railroad Retirement Fund's financial problems.

Labor and management are supporting a comprehensive solution to the financial problems of the retirement system currently being considered by the Congress. The package includes increases in the tax on both employers and employees, certain benefit adjustments, and limited borrowing authority against amounts owed to Fund by the Social Security Trust Fund. All interested parties have offered to make sacrifices to make the system work. The package will deal adequately, fairly, and, we believe, permanently with the financial problems of the Railroad Retirement system. There will be no need for the changes proposed in the GAO report if the changes supported by labor and management are enacted, and without these latter changes, the former changes would be totally inadequate. Accordingly, we strongly urge that no proposal be made which might in any way confuse the proposal now under consideration.

Changes in Railroad Retirement have traditionally arisen from the collective bargaining process. As the congressional committees, which recommended enactment of the Railroad Retirement Act of 1974, recognized, Tier II constitutes "in essence, a company pension plan administered, for historical reasons, by the Federal Government," and those committees accordingly contemplated that "[f]uture changes... will arise out of collective bargaining between the railroads and the unions." H. Rept. No. 93-1345, at 16-17; S. Rept. No. 93-1163, at 16-17. Changes in the Railroad Retirement system ought not to be proposed to Congress without first being considered in the collective bargaining context.

The package of changes now under consideration by Congress entails substantial financial sacrifices by both employers and employees, and represents a delicate balance of competing interests. Even a small shift in the relative financial burdens could destroy this balance. Therefore, we again urge that GAO make no proposal to change Railroad Retirement which has not first gone through this exhaustive process.

With respect to use of the Department of the Treasury's "Treasury Financial Communications System" (TFCS), the railroads are not opposed to pursuing its use, provided all Railroad Retirement funds would be remitted directly to the Railroad Retirement Board. Although TFCS appears to be one possible solution to the slow transfer of funds to the Board, the problem centers on the Treasury's inability to remit the funds on a timely basis and not on the railroads' use or non-use of TFCS.

In addition to the Treasury's loss of float, estimated in your report to be approximately $7 million, the Treasury would also experience a reduction in revenues of approximately $10 million as a result of the railroads' loss of an estimated $21.5 million in pretax income times the corporate tax rate of 46 percent.

In closing, the railroad industry thanks you for the opportunity to present its views in this important area. While the railroads are willing to cooperate in switching to TFCS, we urge that GAO make no recommendation with respect to Railroad Retirement tax deposit requirements.

Sincerely,

William H. Dempsey

William H. Dempsey

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