OFFICE OF THE UNDER SECRETARY OF DEFENSE
4000 DEFENSE PENTAGON
WASHINGTON, D.C. 20301-4000

PERSONNEL AND
READINESS

MAY 19 2003

The Honorable Duncan Hunter
Chairman, Committee on Armed Services
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This letter forwards a Department of Defense (DoD) Report on integrating Basic Allowance for Subsistence (BAS) into Basic Pay, requested by the Bob Stump National Defense Authorization Act for Fiscal Year 2003, House Armed Services Committee Report 107-436. The purpose of this report is to evaluate the feasibility of eliminating BAS as an allowance. The report reviews the current DoD BAS policy and provisions of law, outlines cost implications, and discusses implementation strategies to eliminate BAS as a separate allowance.

Although the Department agrees with the Committee that the usefulness of BAS as a separate compensation element is reduced when all members of a given status receive the same cash allowance, the cost to convert BAS from a non-taxable allowance to an equal-value increment to basic pay is prohibitive. The additional cost to the Government would be $1.8 billion per year. In response to the Committee's concern that not all Service members receive full BAS while on deployment, the Department is evaluating an initiative as part of its fiscal year 2006 legislative program to authorize free meals for Service members who are deployed on field or sea duty during times of war or National emergency.

Sincerely,

Charles S. Abell
Principal Deputy

cc: The Honorable Ike Skelton
Ranking Member

Report to Congress

Integrating Basic Allowance for Subsistence into Basic Pay

March 31, 2003

Directorate of Compensation
Office of the Under Secretary of Defense
Personnel and Readiness
(Military Personnel Policy)

Introduction

The Bob Stump National Defense Authorization Act for Fiscal Year 2003, House Armed Services Committee Report 107-436 requested the Secretary of Defense to study whether or not to integrate Basic Allowance for Subsistence (BAS) into Basic Pay, examine the cost implications, develop implementation strategies, and determine the Department of Defense position on this issue.

This report reviews the current DoD BAS policy and provisions of law, outlines cost implications and implementation strategies to eliminate BAS as a separate allowance, and recommends the Department's position.

DOD Policy and Current provision of law

Basic Allowance for Subsistence is paid to members of the Armed Forces to defray a portion of their food costs. BAS is paid at a flat rate regardless of rank or time-in-service. All officers are paid the same rate, which for fiscal year 2003 is $167.20 monthly. Enlisted members are paid one of two monthly rates in fiscal year 2003: 1) When authorized to mess separately ($242.81), 2) When rations in-kind are not available ($262.50).

BAS is non-taxable. This means that every dollar in allowance the member receives is equivalent to a higher amount of pre-tax dollars. The tax advantage is comprised of federal income tax, state income tax (if the member is a legal resident of a state that taxes military pay) and Social Security and Medicare (FICA) taxes. For the purposes of this report no consideration was given to the state income tax advantage, since 67% of all Service members do not pay state income taxes. For fiscal year 2003 the officer and enlisted tax advantage is computed as follows (Table 1):

	Officers	Enlisted
FY 2003 BAS Allowance	$167.20/month	$242.81/month
Federal Income Tax Advantage (Marginal Tax Bracket 16%)	$31.80/month	$46.18/month
Employee FICA Costs (7.65%)	$12.79/month	$18.57/month
Employer FICA Costs (7.65%)	$12.79/month	$18.57/month

Table 1

The current provision of law pertaining to BAS is set forth in section 402, title 37, U.S. Code. This Section provides that each member who is entitled to basic pay is also entitled to BAS with few minor exceptions. All members are required to pay for meals furnished by the government while they are entitled to BAS. In certain circumstances, members may have the amount of meals deducted directly from their pay account or reduced from their travel per diem.

For certain assignments, members may be ordered to eat in government dining facilities, in which case they are charged for meals whether consumed or not.

Cost Implications and Implementation Strategies

This report evaluates three options considered by the Department to integrate BAS into basic pay: 1) Absorb BAS into basic pay with an increased retirement benefit, but no compensation for the loss of the tax advantage; 2) Absorb BAS into basic pay and compensate the member for the loss of the federal tax advantage, but with no increase to retirement benefits; and 3) Absorb BAS into basic pay, compensate the member for the loss of the federal tax advantage, and increase retirement benefits. For each option, pros and cons, costs and implementation strategies were developed. The minimum additional cost to the Department to eliminate BAS as an allowance is $1.8 billion per year.

.

Option One

ABSORB BAS INTO BASIC PAY WITH AN INCREASE TO RETIREMENT BENEFITS, BUT NO COMPENSATION FOR TAX ADVANTAGE

In this option basic pay would be increased by the monthly BAS rate, the additional costs to the Department would be comprised of increased employer's share of Social Security and Medicare taxes, and the annual retired pay accrual costs for both active duty and reserves. In addition, there would be an increase to reserve drill pay. The annual additional cost to the Department for this option would be $1.8 billion per year (Table 2).

Total Costs for Option One:

	Cost per Member		DOD Personnel		Total Annual Costs
Active Duty Enlisted	$1,097	x	1,153,378	=	$1,265,255,666
Active Duty Officer	$756	x	216,814	=	163,911,384
Reserve Enlisted	$477	x	744,163	=	354,794,594
Reserve Officer	$328	x	130,130	=	42,670,928
Total Cost					$1,826,632,572

Table 2

The additional costs to the Service member would be the employee's share of Social Security and Medicare taxes, federal income taxes, and if paid, state income taxes. The actual increased income tax burden for each member would depend on his or her individual circumstances, (i.e. family size, additional family income, tax deductions such as mortgage interest, charitable deductions etc.). In this option, the increased tax burden would be counterbalanced by an increase in the value of retirement pay (Table 3). In addition, since the member would be paying higher Social Security payments, Social Security benefits would be increased. Table 4 is a list of the pros and cons for this option.

Increased retirement benefits if BAS were absorbed into Basic Pay:

		Initial Monthly Retirement Pay and Present Value of Expected Life Time Pay		
Grade	Years of Service	High Three	High Three + BAS	Delta Increase
E-6	20	$1,170 $313,237	$1,292 $345,899	$122 $32,662
E-7	22	$1,494 $387,122	$1,627 $421,585	$133 $34,463
E-8	26	$2,163 $521,287	$2,321 $559,365	$158 $38,078
E-9	30	$2,995 $664,155	$3,177 $704,514	$182 $40,359
O-5	20	$2,719 $752,939	$2,803 $776,200	$84 23,261
O-6	30	$5,361 $1,247,125	$5,486 $1,276,204	$125 $29,079

Table 3

Pros and Cons for Option One:

Pros:	Cons:
➢ **Increases a member's retirement pay encouraging longer careers**	➢ **Increases cost to the Government (over $1.8 Billion)**
➢ **Eliminates separate accounting and administration for BAS**	➢ **The impact of the additional income tax expenses will affect members differently because the tax advantage is individual specific**
➢ **Eliminates perception that Service members are being paid twice for food when deployed TDY**	➢ **Members may perceive transition as a loss of benefits**
➢ **Increased tax burden for individuals would be counterbalanced by an increase in the value of retirement pay**	➢ **Reduces overall value of the current BAS allowance**
➢ **Increased Reserve benefits may improve recruiting and retention efforts**	➢ **Majority of Service members do not retire and therefore will not recoup loss of purchasing power as increased retirement pay**
➢ **Now that all members receive BAS, allowance status no longer serves as useful differential of pay between members**	

Table 4

The Department believes this is the most feasible option to eliminate the BAS allowance, but the additional expense to the Government outweighs any benefits achieved by implementing this option. The Department recognizes that the need for an allowance as a separate element of compensation is reduced when all the members of a given status receive the same cash allowance. Since BAS reform in 1995, all members, with very minor exceptions, receive BAS

as a cash allowance. If not for the high cost of moving the cash equivalent of BAS into basic pay, it would be feasible and desirable to eliminate BAS as an allowance as long as Service Secretaries retain the flexibility to establish governing mandates of who must eat in dining facilities. Members would be charged for mandatory meals at their permanent duty station.

Option Two

ABSORB BAS INTO BASIC PAY PLUS COMPENSATE MEMBERS FOR THE LOSS OF THE FEDERAL TAX ADVANTAGE BUT WITH NO INCREASE TO RETIREMENT BENEFITS

This option would increase basic pay by the current BAS rate plus compensate for the loss of the federal tax advantage. However, there would be no increase to retirement benefits.

The additional costs to the Department for this option are the amount members are compensated for the loss of the federal tax advantage and both the employer and employee's portion of FICA costs. As in option 1, this option would also increase reserve drill costs (Table 5). This option would require legislation to change how the retirement multiplier is computed so retirement benefits would not be increased.

Total Costs for Option Two:

	Cost per Member		DOD Personnel		Total Annual Costs
Active Duty Enlisted	$1,084	x	1,153,378	=	$1,250,261,752
Active Duty Officer	$746	x	216,814	=	161,743,244
Reserve Enlisted	$418	x	744,163	=	311,402,449
Reserve Officer	$288	x	130,130	=	37,452,715
Total Cost					$1,760,860,160

Table 5

To compute the amount of the federal tax advantage lost under this option, the Department used the marginal tax bracket of 16% which is the average "actual" marginal tax bracket for service members as determined by the 7th QRMC. Adding the tax advantage will not leave all members equally compensated, because as stated above, the actual federal income tax advantage depends on individual circumstances. However, in most cases junior members pay less than the 16% marginal tax bracket while more senior members usually pay at a higher marginal tax bracket. In addition, it could be argued that the amount the member is compensated for the federal income tax advantage is not an increased cost to the government since the tax money is returned to the general treasury.

The additional cost to the Department for this option is $1.76 billion. Table 6 provides the pros and cons for this option.

Pros and Cons for Option Two:

Pros:	Cons:
➢ **Eliminates separate accounting and administration for BAS**	➢ **Increases cost to the Government (almost $1.8 Billion)**
➢ **Eliminates perception that Service members are being paid twice for food when deployed TDY**	➢ **Impact of additional income will affect members differently because the tax advantage is individual specific**
➢ **Increased Reserve drill pay may improve recruiting and retention efforts**	➢ **Members may perceive transition as a loss of benefits**
➢ **Now that all members receive BAS, allowance status no longer serves as useful differential of pay between members**	

Table 6

The Department does not recommend this option because it is impossible to accurately compensate each member for their lost tax advantage since the actual value of the tax advantage is specific to the individual. The additional cost to the government also significantly outweighs the savings accrued for eliminating BAS.

Option Three

ABSORB BAS INTO BASIC PAY PLUS COMPENSATE MEMBERS FOR THE LOSS OF THE FEDERAL TAX ADVANTAGE AND INCREASE THEIR RETIREMENT BENEFITS

This option would increase basic pay by the current BAS rate plus compensate for the loss of the Federal tax advantage and increase retirement benefits.

The additional costs to the Department for this option are the amount members are compensated for the loss of the federal tax advantage, both the employer and employee's portion of FICA costs, and the annual accrual retirement costs for both active duty and reserves. In addition, there would also be an increase to reserve drill and retirement costs (Table 7).

Total costs for Option Three:

	Cost per Member		DOD Personnel		Total Annual Costs
Active Duty Enlisted	$2,203	x	1,153,378	=	$2,540,891,734
Active Duty Officer	$1,517	x	216,814	=	328,906,838
Reserve Enlisted	$477	x	744,163	=	354,794,594
Reserve Officer	$328	x	130,130	=	42,670,928
Total Cost					$3,267,264,094

Table 7

This option is the best from the member's perspective, but is the most expensive to implement. The increased cost for this option is $3.3 billion per year. Table 8 provides the pros and cons for this option.

Pros and Cons for Option Three:

Pros:	Cons:
➢ **Increases a member's retirement pay encouraging longer careers**	➢ **Increases cost to the Government (almost $3.3 Billion)**
➢ **Eliminates separate accounting and administration for BAS**	➢ **Impact of the additional income will affect members differently because the value of the tax advantage is specific to the individual.**
➢ **Eliminates perception that Service members are being paid twice for food when deployed TDY**	➢ **Members may perceive transition as a loss of benefits**
➢ **Increased Reserve benefits may improve recruiting and retention efforts**	
➢ **Now that all members receive BAS, allowance status no longer serves as useful differential of pay between members**	
➢ **The increased tax burden for individuals would be counterbalanced by an increase in the value of retirement pay**	

Table 8

The Department believes this is the fairest method to compensate members if BAS were to be absorbed into basic pay. However, this option is not recommended since the large associated cost does not justify the benefits gained by eliminating BAS. This is the only option that Service members will perceive as maintaining their current benefits. But as in option two, it is impossible to accurately compensate members for their lost tax advantage since the value of the tax advantage is specific to the individual.

Conclusions

The Department recognizes that usefulness of a BAS allowance as a separate element is reduced when all members of a given status receive the same cash allowance. However, the cost to convert BAS from a non-taxable allowance to an equivalent value added to basic pay without adversely impacting the member is too expensive for the benefits gained.

The Department will continue to study the feasibility of a simplified pay system with basic pay reflecting status, special and incentive pays to cover skill differentials, and a single locality-based cost of living allowance to account for regional price variation. It may be more feasible to eliminate BAS as a separate allowance as part of a fundamental structural overhaul of the pay system.

As the House Armed Services Committee points out, under certain circumstances some Service members' BAS is reduced when the Government provides meals while others serving at

the same duty location receive their full BAS. This is especially true when some members are deployed on Temporary Duty (TDY) orders while others are assigned Permanent Change of Station (PCS) orders. When a member is deployed on TDY orders, meals provided by the government are charged to travel per diem and the member retains his or her BAS. In addition, the most common complaint the Services receive regarding BAS is that when a member deploys, his pay is often reduced for meals provided by the Government. Military families complain that the member is being sent in harm's way and at the same time their pay is being reduced. The Department of Defense is evaluating the possible inclusion of legislation in the Department's fiscal year 2006 budget to authorize meals at no cost to Service members while they are deployed on field or sea duty, especially during times of war or National emergency.