

Taxation of Disability Retirement Benefits

By Captain Samuel F. Wright, JAGC, USN (Ret.)²

6.0—Military Service and Tax Law

Q: I served on active duty in the Active Guard and Reserve program for more than 20 years. A serious medical condition was discovered during my retirement physical, and I filed a claim with the Department of Veterans Affairs (VA) for a service-connected disability. The VA lost my paperwork twice and eventually decided the claim in my favor more than four years after I filed, rating my service-connected disability at 40 percent.

I understand that I am precluded from concurrently receiving disability compensation from the VA and military retirement from the Army, but I at least want to get the tax break that goes with the disability compensation. As I understand it, that part of my pay that represents compensation for the service-connected disability is not taxable, but that part of my retired pay that represents deferred compensation for my 20 years of Active Duty is taxable.

I sought to file amended tax returns for the four years since I retired from the Army, in order to get the tax break based on the VA's belated favorable adjudication of my disability claim. My tax lawyer tells me that I can only file amended returns and get tax refunds for the last two years,

¹I invite the reader's attention to <https://www.roa.org/page/LawCenter>. You will find more than 2000 "Law Review" articles about the Uniformed Services Employment and Reemployment Rights Act (USERRA), the Servicemembers Civil Relief Act (SCRA), the Uniformed and Overseas Citizens Absentee Voting Act (UOCAVA), the Uniformed Services Former Spouse Protection Act (USFSPA), and other laws that are especially pertinent to those who serve our country in uniform. You will also find a detailed Subject Index, to facilitate finding articles about specific topics. The Reserve Officers Association, now doing business as the Reserve Organization of America (ROA), initiated this column in 1997.

²BA 1973 Northwestern University, JD (law degree) 1976 University of Houston, LLM (advanced law degree) 1980 Georgetown University. I served in the Navy and Navy Reserve as a Judge Advocate General's Corps officer and retired in 2007. I am a life member of ROA. For 43 years, I have worked with volunteers around the country to reform absentee voting laws and procedures to facilitate the enfranchisement of the brave young men and women who serve our country in uniform. I have also dealt with the Uniformed Services Employment and Reemployment Rights Act (USERRA) and the Veterans' Reemployment Rights Act (VRRRA—the 1940 version of the federal reemployment statute) for 36 years. I developed the interest and expertise in this law during the decade (1982-92) that I worked for the United States Department of Labor (DOL) as an attorney. Together with one other DOL attorney (Susan M. Webman), I largely drafted the proposed VRRRA rewrite that President George H.W. Bush presented to Congress, as his proposal, in February 1991. On 10/13/1994, President Bill Clinton signed into law USERRA, Public Law 103-353, 108 Stat. 3162. The version of USERRA that President Clinton signed in 1994 was 85% the same as the Webman-Wright draft. USERRA is codified in title 38 of the United States Code at sections 4301 through 4335 (38 U.S.C. 4301-35). I have also dealt with the VRRRA and USERRA as a judge advocate in the Navy and Navy Reserve, as an attorney for the Department of Defense (DOD) organization called Employer Support of the Guard and Reserve (ESGR), as an attorney for the United States Office of Special Counsel (OSC), as an attorney in private practice, and as the Director of the Service Members Law Center (SMLC), as a full-time employee of ROA, for six years (2009-15). Please see Law Review 15052 (June 2015), concerning the accomplishments of the SMLC. My paid employment with ROA ended 5/31/2015, but I have continued the work of the SMLC as a volunteer. You can reach me by e-mail at SWright@roa.org.

because the Internal Revenue Code has a two-year statute of limitations. Is that correct? The way that this situation has been handled seems fundamentally unfair.

A: This is exactly the sort of scenario about which the "concurrent receipt" debate in Congress relates. The Congressional Research Service (CRS), a part of the Library of Congress, provides legal research and other research to Congress. I have found an excellent discussion of the concurrent receipt issue in CRS Issue Brief for Congress No. IB85159, titled "Military Retirement: Major Legislative Issues." This document was most recently updated on Mar. 14, 2006.³ It states:

"Until 2004, the law provided that military retired pay had to be reduced by the amount of VA disability compensation. Some maintained this was inequitable and unfair; it was defended on the grounds of cost and of the need to avoid setting a precedent for concurrent receipt of numerous other federal benefits. Starting in 1999 (Fiscal Year 2000), provisions in each year's annual National Defense Authorization Act (NDAA) authorized payments to comparatively small groups (in the tens of thousands) of military retirees in lieu of concurrent receipt. The program enacted in 2002, in the FY 2003 NDAA (P.L. 107-314), is known as 'Combat Related Special Compensation' (CRSC), although it applies also to those people injured in military operations and training generally, as distinct from those whose injuries are unrelated to military service but incurred while in service. CRSC provides for payments that are the financial equivalent of concurrent receipt. The FY 2004 NDAA (P.L. 108-136, Nov. 24, 2003), for the first time provided the concurrent receipt or its practical and financial equivalence to large numbers of military retirees. The law, effective Jan. 1, 2004, (1) authorized payments of CRSC to all otherwise eligible military retirees, regardless of their percentage of disability; (2) authorized a 10-year phase-in of concurrent receipt for all military retirees whose disability is 50 percent or greater, regardless of the origins of their disability; and (3) included (hitherto almost completely excluded) Reserve retirees. The FY 2005 NDAA (P.L. 108-375, October 28, 2004; 118 Stat. 1811) expanded concurrent receipt eligibility by authorizing the immediate (rather than a 10-year phase-in) concurrent receipt for military retirees with a 100 percent service-connected disability." (emphasis in original)

These changes are most welcome, but they don't help you because your disability, as determined by the VA, is less than 50 percent and is not the result of an injury or wound incurred in a military operation or training. However, the tax break on the part of your pay that represents compensation for a service-connected disability is definitely worthwhile to a person in your situation.

Your tax attorney is correct: under current law the statute of limitations for refund claims is two years. See 26 U.S.C. 6511(a). Rep. Bob Filner (D-Calif.), chairman of the House Veterans Affairs Committee, has introduced H.R. 2234, the Disabled Veterans Tax Fairness Act of 2007. If enacted, Rep. Filner's bill would permit a person in your situation to file for a refund going back 15 tax years.

³<https://sgp.fas.org/crs/natsec/IB85159.pdf>

Your situation also illustrates the need for the VA to update its ancient paper-based system and to address its backlog of claims. Justice delayed is often justice denied.

Update – May 2022

H.R. 2234, the Disabled Veterans Tax Fairness Act of 2007 has not been enacted.

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Indeed, ROA is the *only* national military organization that exclusively supports America’s Reserve and National Guard.

Through these articles, and by other means, we have sought to educate service members, their spouses, and their attorneys about their legal rights and about how to exercise and enforce those rights. We provide information to service members, without regard to whether they are members of ROA or eligible to join, but please understand that ROA members, through their dues and contributions, pay the costs of providing this service and all the other great services that ROA provides.

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