

LAW REVIEW¹ 14025

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SCRA Interest Rate Reduction Does Not Mean Taxable Income

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[About Sam Wright](#)

4.1—SCRA right to interest rate reduction upon mobilization

6.0—Military service and tax laws

Q: I am an Army Reserve Captain and a member of ROA. Last year, I was called to active duty and deployed to Afghanistan, where I am currently serving. Even with the hazardous duty pay and the tax break for serving in a combat zone, I made substantially less money in 2013 on active duty than I had been making in my well paid civilian job.

I have heard that the Soldiers' and Sailors' Civil Relief Act (SSCRA) provides that a person entering active duty with pre-service financial obligations is entitled to have the interest rate

¹I invite the reader's attention to www.roa.org/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 very 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 (VRRA—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 VRRA 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 VRRA 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.

on those obligations reduced to 6% while on active duty. I applied for and received those reductions on my two outstanding credit card balances, shortly after I entered active duty.

Now, our tax advisor is helping my husband (who is back home with the kids) to prepare our 2013 federal income tax return. The tax advisor told my husband that the interest rate reduction must be reported as 2013 income and that we must pay tax on that income. Is my tax advisor correct?

A: No. Your tax advisor is wrong. Under most circumstances, a forgiveness of the *principal* of a debt is taxable income to the debtor whose debt was forgiven, but a reduction in the rate of interest does not result in taxable income to the debtor.

Here is a link to a definitive publication about the concept of treating debt forgiveness as income: http://www.ehow.com/about_7269475_cancellation-debt-taxable-income_.html. With certain exceptions (including the situation where a debt is forgiven as part of a bequest in a will), a forgiven debt amounts to taxable income for the debtor whose debt was forgiven, but this applies to a forgiveness of part or all of the principal of the debt. A reduction in the rate of interest cannot, under any circumstances, amount to taxable income for the debtor.

In 2003, Congress enacted the Servicemembers Civil Relief Act (SCRA), as a long-overdue rewrite of the SSCRA, which was originally enacted in 1917. Here is the text of the pertinent SCRA section:

“(a) Interest rate limitation.

(1) Limitation to 6 percent. An obligation or liability bearing interest at a rate in excess of 6 percent per year that is incurred by a servicemember, or the servicemember and the servicemember's spouse jointly, before the servicemember enters military service shall not bear interest at a rate in excess of 6 percent--
(A) during the period of military service and one year thereafter, in the case of an obligation or liability consisting of a mortgage, trust deed, or other security in the nature of a mortgage; or
(B) during the period of military service, in the case of any other obligation or liability.
(2) Forgiveness of interest in excess of 6 percent. Interest at a rate in excess of 6 percent per year that would otherwise be incurred but for the prohibition in paragraph (1) is forgiven.
(3) Prevention of acceleration of principal. The amount of any periodic payment due from a servicemember under the terms of the instrument that created an obligation or liability covered by this section shall be reduced by the amount of the interest forgiven under paragraph (2) that is allocable to the period for which such payment is made.

“(b) Implementation of limitation.

(1) Written notice to creditor. In order for an obligation or liability of a servicemember to be subject to the interest rate limitation in subsection (a), the servicemember shall provide to the creditor written notice and a copy of the military orders calling the servicemember to military service and any orders further extending military service, not later than 180 days after the date of the servicemember's termination or release from military service.

(2) Limitation effective as of date of order to active duty. Upon receipt of written notice and a copy of orders calling a servicemember to military service, the creditor shall treat the debt in accordance with subsection (a), effective as of the date on which the servicemember is called to military service.

(c) Creditor protection. A court may grant a creditor relief from the limitations of this section if, in the opinion of the court, the ability of the servicemember to pay interest upon the obligation or liability at a rate in excess of 6 percent per year is not materially affected by reason of the servicemember's military service.

(d) Definitions. In this section:

(1) Interest. The term "interest" includes service charges, renewal charges, fees, or any other charges (except bona fide insurance) with respect to an obligation or liability.

(2) Obligation or liability. The term "obligation or liability" includes an obligation or liability consisting of a mortgage, trust deed, or other security in the nature of a mortgage.

(e) Penalty. Whoever knowingly violates subsection (a) shall be fined as provided in title 18, United States Code, imprisoned for not more than one year, or both.

(f) [Deleted]"

50 U.S.C. App. 527.¹

Under this provision, the interest rate is reduced, and interest in excess of 6% per year is forgiven. The SCRA does not require a creditor to forgive part or all of the principal of a debt. The implementation of section 527 with respect to your two credit card balances did not result in tax consequences for you.

Update – March 2022³

The location of the SCRA within the United States code changed in late 2015. Previously codified at 50 U.S.C App. §§ 501-597(b), there was an editorial reclassification of the SCR by the Office of the Law Revision Counsel to the United States House of Representatives that became effective on December 1, 2015.⁴ The SCRA is now codified at 50 U.S.C. §§ 3901-4043. The changes in codification have not changed the substance or application of the rules. Therefore, the article is just as relevant as it is today as when it was written in 2014.

The relevant section cited in the article can now be found as followed:

³Update My Second Lieutenant Lauren Walker, USMC.

⁴*The Servicemembers Civil Relief Act (SCRA)*, THE UNITED STATES DEPARTMENT OF JUSTICE, <https://www.justice.gov/servicemembers/servicemembers-civil-relief-act-scra> (last visited Mar. 10, 2022).

50 U.S.C. App. § 527 discussing the maximum rate of interest on debts incurred before military service can be found at U.S.C. § 3937.

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ROA is almost a century old—it was established on 10/1/1922 by a group of veterans of “The Great War,” as World War I was then known. One of those veterans was Captain Harry S. Truman. As President, in 1950, he signed our congressional charter. Under that charter, our mission is to advocate for the implementation of policies that provide for adequate national security. For almost a century, we have argued that the Reserve Components, including the National Guard, are a cost-effective way to meet our nation’s defense needs.

Through these articles, and by other means, including amicus curiae (“friend of the court”) briefs that we file in the Supreme Court and other courts, we educate service members, military spouses, attorneys, judges, employers, DOL investigators, ESGR volunteers, congressional and state legislative staffers, and others about the legal rights of service members and about how to exercise and enforce those rights. We provide information to service members, without regard to whether they are members of ROA, 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.

If you are now serving or have ever served in any one of our nation’s eight⁵ uniformed services, you are eligible for membership in ROA, and a one-year membership only costs \$20 or \$450 for a life membership. Enlisted personnel as well as officers are eligible for full membership, and eligibility applies to those who are serving or have served in the Active Component, the National Guard, or the Reserve. If you are eligible for ROA membership, please join. You can join on-line at www.roa.org or call ROA at 800-809-9448.

If you are not eligible to join, please contribute financially, to help us keep up and expand this effort on behalf of those who serve. Please mail us a contribution to:

Reserve Organization of America
1 Constitution Ave. NE

⁵Congress recently established the United States Space Force as the 8th uniformed service.