

## Part I

### Section 61. –Gross Income Defined

26 CFR 1.61-1: Gross income.  
(Also §§ 134, 140; § 1.6041-1.)

Rev. Rul. 2007-69

#### ISSUES

(1) Are payments made by the U.S. Department of Veterans Affairs (VA) under the compensated work therapy program described in 38 U.S.C. § 1718 (CWT program) exempt from federal income tax as veterans' benefits?

(2) Are payments made by the VA under the CWT program required to be reported on an information return?

#### FACTS

The CWT program administered by the VA provides assistance to veterans unable to work and support themselves. Many of the veterans in the program have histories of one or more conditions such as psychiatric illness, substance abuse, and homelessness. Under the program, the VA provides a range of vocational rehabilitation services, with the degree of structure and level of support provided to the participating veteran geared to his or her needs. The goal of the program is to assist in restoring, to

the maximum extent possible, the physical and psychological functioning of ill or disabled veterans. See 38 U.S.C. § 1701.

Title 38 of the United States Code addresses veterans' benefits. Section 1718, entitled "Therapeutic and Rehabilitative Activities," provides that the VA may enter into contracts with third parties to provide therapeutic work for patients in VA health care facilities. Section 1718(c)(1) establishes the "Department of Veterans Affairs Special Therapeutic and Rehabilitation Activities Fund" (Fund), from which distributions are to be made to patients for therapeutic work. Fund payments are intended to furnish veterans with work skills training, employment support, and job development and placement services, although the primary objective of the program is therapy and rehabilitation. See 38 U.S.C. § 1718(a) and (d).

With respect to the taxation of veterans' benefits, 38 U.S.C. § 5301(a)(1) provides that payments of benefits due or to become due under any law administered by the VA made to, or on account of, a beneficiary shall be exempt from taxation.

#### LAW AND ANALYSIS

Section 61 of the Internal Revenue Code provides that gross income includes all income from whatever source derived, unless specifically excluded by law.

Section 134(a) provides that gross income does not include any qualified military benefit. The term "qualified military benefit" means any allowance or in-kind benefit (other than personal use of a vehicle) which-

(A) is received by any member or former member of the uniformed services of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services, and

(B) was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice that was in effect on such date (other than a provision of Title 26). Section 134(b)(1).

The legislative history to § 134 indicates that the allowances that were authorized on September 9, 1986, and excludable from gross income on that date, include veterans' benefits authorized under 38 U.S.C. § 3101 (now 38 U.S.C. § 5301). See H.R. Conf. Rep. No. 841 (Vol. II), 99<sup>th</sup> Cong. 2d Sess. 548 (1986). See also § 140(a)(3) (cross-referencing 38 U.S.C. § 5301 for the exemption from taxation of benefits under laws administered by the VA).

Rev. Rul. 72-605, 1972-2 C.B. 35, holds that payments of benefits under any law administered by the VA are excludible from the gross income of a recipient.

Rev. Rul. 65-18, 1965-1 C.B. 32, holds that certain payments made by the VA under the CWT program in 38 U.S.C. § 618 (the predecessor to 38 U.S.C. § 1718) are includible in a recipient's gross income as compensation for services, even though intended for therapeutic or rehabilitative purposes. Rev. Rul. 65-18 also requires information reporting on Form 1099 with respect to these payments. See § 1.6041-1(i) (requiring information returns on Form 1099 of certain payments made by any agency of the United States).

In *Wallace v. Commissioner*, 128 T.C. 132 (2007), *acq.*, 2007-44 I.R.B. \_\_\_, the Tax Court disagreed with Rev. Rul. 65-18 and held that payments made by the VA for work performed under CWT programs are exempt from federal income tax as veterans' benefits within the meaning of 38 U.S.C. § 5301.

The Service agrees with the *Wallace* decision that payments made by the VA under the CWT program are veterans' benefits within the meaning of 38 U.S.C. § 5301. Accordingly, the payments are qualified military benefits under § 134 and are exempt from federal income tax.

#### HOLDINGS

(1) Payments made by the VA under the CWT program are exempt from federal income tax as veterans' benefits.

(2) Because payments made by the VA under the CWT program are exempt from federal income tax, the payments are not required to be reported on an information return.

#### EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 65-18 is revoked. Rev. Rul. 72-605 is amplified.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is Michael F. Schmit of the Office of the Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue ruling, contact Mr. Schmit at (202) 622-4960 (not a toll-free call).