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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
November 5, 1999

DO:

TY:

- = Taxpayer
- = Qualified Hazardous Duty Area
- = Reserve Unit

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This is in response to your letter dated June 18, 1999, requesting a ruling whether the exclusion from income for combat pay contained in section 112 of the Internal Revenue Code (the Code) to applies to payments under the Ready Reserve Mobilization Income Insurance Program.

FACTS

Taxpayer, a member of the Reserve Unit, was mobilized and reported for active duty in the armed forces on _____, serving in a public affairs unit in support of operations in the Qualified Hazardous Duty Area. She was discharged on _____.

Taxpayer served in the Qualified Hazardous Duty Area from _____ through _____. During this period, Taxpayer qualified for the income tax exclusion in Code section 112 for active service in a combat zone and received hostile fire pay.

Taxpayer participated in the Ready Reserve Mobilization Income Insurance Program (RRMIIP), a program which became effective on September 30, 1996. 10 U.S.C. sections 12521-12533. The RRMIIP was an insurance program available to members of the ready reserves who were involuntarily called to active duty for more than 30 days. It was intended to replace lost income from civilian employment. Ready reserve members could purchase RRMIIP benefits in increments from \$500 to \$5,000.

Taxpayer applied for a benefit of _____ per month and paid premiums of _____ per month from _____ through _____.

Taxpayer, who was called to active duty on _____, became eligible for RRMIIP benefits on _____, after 30 days of service. On _____, she

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was transferred to the Qualified Hazardous Duty Area. On _____, Taxpayer received an RRMIIIP benefit of _____.

The RRMIIIP was intended to be an actuarially sound program, but the assets available in the insurance fund were insufficient to pay the full amount due. Consequently, beginning with the period October 15, 1997, benefit payments were prorated to 5 percent of the monthly benefit amount. Subsequent to that date, Taxpayer received six bi-monthly payments of _____ between _____, and _____, and a payment of _____ on _____.

In May 1998 Congress enacted a supplemental appropriation bill to fund the RRMIIIP. On _____, Taxpayer received a payment of _____.

LAW

Code section 61(a) includes in gross income all income from whatever source derived, unless otherwise excluded. Section 61(a)(1) defines gross income as including compensation for services, including fringe benefits and similar items.

Code section 112(a) provides that gross income does not include "compensation received for active service" as a member below the grade of commissioned officer in the Armed Forces of the United States for any month during any part of which the member "served in a combat zone."

Section 112(c)(2) provides that the term "combat zone" means any area which the President of the United States by Executive Order designates for purposes of this section as an area in which Armed Forces of the United States are or have engaged in combat.

Section 1(a)(2) of Pub. L. 104-117, 110 Stat. 827 (1996), provides that, for purposes of section 112, a qualified hazardous duty area shall be treated in the same manner as if it were a combat zone. Subsection (b) defines the term qualified hazardous duty area to include, among other places, the Qualified Hazardous Duty Area, if the member of the Armed Forces is entitled to special pay for hostile fire or imminent danger for services performed. This statute took effect on November 21, 1995.

Section 1.112-1(b)(4) of the Income Tax Regulations states that, when compensation is received for active duty in a combat zone, the time and place of payment are irrelevant in considering whether compensation is excludable under section 112. Rather, the time and place of the entitlement to compensation determine whether the compensation is excludable under section 112.

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In Waterman v. Commissioner, 179 F.3d 123 (4th Cir. 1999), aff'g 110 T.C. 103 (1998), the 4th Circuit addressed the meaning of the statutory phrase “compensation received for active service” in a combat zone. It concluded that a severance payment, though elected while the taxpayer served in a combat zone, was not compensation received for active service, but for the taxpayer’s agreement to resign from the Navy. Hence section 112(a) does not exclude the payment, and consequently the timing rule of section 1.112-1(b)(4), Income Tax Regs, providing that the time and place of entitlement determine whether compensation is excludable under section 112, has no application.

The RRMIP was adopted by Congress, effective September 30, 1996, as part of the National Defense Authorization Act for 1996. The report of the House Committee on National Security on H.R. 1530 describes the nature and purpose of the program:

The committee is aware of the many financial hardships endured by reserve members involuntarily called to active duty during the Persian Gulf War. The committee recognizes the need for income protection for mobilized reserve members.

This section would establish an income protection insurance plan for ready reserve members. The plan would provide a \$1,000-per-month base benefit to reservists involuntarily called to active duty in support of an operational mission during a period of war or national emergency as declared by the President. The plan would be financed by premiums paid by individual members. Members would be automatically enrolled for the base benefit unless the member declines to participate, selects a lower benefit of half the basic benefit, or selects a greater amount up to a maximum of \$5,000 per month at additional cost.

104th Cong, 1st Sess., Rpt. No. 104-131 (June 1, 1995).

The purpose of the RRMIP is expressed in section 12523(a), which states, “The insurance program shall insure members of the Ready Reserve against the risk of being ordered into covered service.” Section 12523(b)(2) states that payment shall be based solely on the insured status of a member and on the period of covered service served by the member.

Section 12524(b) refers to election of a benefit amount. Section 12526(a)(2) provides that premium rates shall be established for the insurance plan and that the Secretary shall prescribe the rate on the basis of the best available estimate of risk and financial exposure, etc.

The program involved the creation of a fund to pay benefits which was to be maintained on an actuarially sound basis. 10 U.S.C. section 12528(a). If the liabilities of the fund exceeded its assets, the Secretary was to request the President to submit to

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Congress a request for a special appropriation. If an appropriation was not made to cover an unfunded liability, benefits were to be reduced. Benefits were authorized to be paid only from the fund or from additional appropriations. 10 U.S.C. section 12529(e). In addition, the Secretary of Defense was authorized to purchase commercial insurance. 10 U.S.C. section 12531(a).

Coverage of individual members was terminated if they failed to make premium payments for two consecutive months. 10 U.S.C. section 12532(a).

In 1998 Congress enacted a supplemental appropriation bill to fund the RRMIIIP and to terminate the program. Pub. L. 105-85, 111 Stat. 1729 (1998). Section 12533(d) of Pub. L. 105-85 provides that payments shall be made to insured members who are serving on active duty or have served but not received their benefits. The fund was closed after the last benefit payment was made. Section 12533(e).

Rev. Rul. 59-5, 1959-1 C.B. 12, holds that unemployment benefits derived from a private fund established and contributed to by members constitute gross income to the member when received to the extent they exceed the amount which the member personally contributed to the fund. See also Williams v. Commissioner, 35 T.C. 685 (1961); Johnson v. Wright, 175 F. Supp. 215 (D. Idaho, 1959) (amounts received from private unemployment insurance fund, in excess of amounts contributed to the fund, are taxable income).

ANALYSIS

The exclusion from gross income of section 112(a) applies to compensation received for active service for any month during any part of which the member served in a combat zone. Payments under the RRMIIIP are described in the establishing legislation as an insurance benefit intended to replace lost civilian income. Taxpayer elected to be covered under the RRMIIIP, pursuant to a contractual arrangement in which benefits were based upon premiums paid. RRMIIIP payments therefore do not constitute compensation received for active service but rather an insurance benefit intended to replace lost civilian income.

Taxpayer argues that Congress' purpose in establishing the RRMIIIP was compensatory and that compensation includes fringe benefits. Section 61(a)(1). While section 61(a) defines income broadly, section 112 contains an exclusion from income. "It is a longstanding rule of statutory interpretation that statutes providing exclusions from income must be construed narrowly." Kovacs v. Commissioner, 100 T.C. 124, 128 (1993), aff'd 25 F.3d 1048 (6th Cir. 1994), citing Commissioner v. Jacobson, 336 U.S. 28, 49 (1949).

We cannot characterize an insurance benefit intended to replace civilian income, for which a member cannot qualify except by paying a premium as falling within the

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exclusion from income for “compensation received for active service” in a combat zone. Being called to active duty was a condition precedent to receiving the benefit, but the benefit was not received for active military service. It was received in satisfaction of a contractual right, consideration for which was the payment of premiums at a specified level. The fact that Congress appropriated additional money to pay benefits under the RRMIP does not change our conclusion, as in so doing it was fulfilling a commitment to fund the program.

The Waterman case provides an analogue in which a member of the armed forces qualified for a payment while serving in a combat zone. The Appellate Court held that the payment, while it was part of the member’s compensation, was not received for service in a combat zone and hence did not qualify for the section 112 exclusion.

The special timing rule of section 112-1(b)(4), Income Tax Regs, has no application to this case because the payments in question are not compensation for active service in a combat zone. Waterman v. Commissioner, supra.

Under Rev. Rul. 59-5, Taxpayer is entitled to exclude from gross income the amount of an insurance payment representing premiums which she contributed to the fund.

We therefore conclude that payments under the RRMIP are included in gross income to the extent they exceed the amount which Taxpayer contributed to the fund.

Sincerely,

Jerry E. Holmes
Chief, Branch 2
Office of Associate Chief Counsel
(Employee Benefits & Exempt Organizations)

cc: