



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

CHIEF COUNSEL

Number: **INFO 2006-0087**
Release Date: 12/29/2006

UIL: 104.04-00 September 19, 2006

CONEX-139197-06

The Honorable Tammy Baldwin
Member, U.S. House of Representatives
10 East Doty Street, Suite 405
Madison, Wisconsin 53703

Attention:

Dear Congresswoman Baldwin:

This letter responds to your e-mail dated August 16, 2006, asking whether veterans can receive a refund of income taxes withheld from Special Separation Benefits that they received before the Veteran's Administration (VA) determined they were entitled to disability compensation.

Gross income means all income from whatever source derived, including compensation for services (section 61 of the Internal Revenue Code (the Code)). A member of the Armed Forces who is involuntarily released from active duty must include separation benefits in gross income in the taxable year received (Revenue Ruling 67-350, 1967-2 C.B. 58).

An individual can exclude from gross income amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces (section 104(a)(4) of the Code). This exclusion applies to an individual if, on application, he or she would be entitled to receive disability compensation from the VA (section 104(b)(4) of the Code).

Occasionally, the VA determines that a veteran who received separation benefits, which are taxable, is entitled to disability compensation (which is not taxable) retroactive to the date he or she separated from the Armed Forces. In that event, regardless of the form of separation benefit the veteran received, the law requires some kind of offset of the disability compensation and the separation benefit. Thus, the VA offsets the separation benefits by withholding disability compensation payments until it recoups previously paid separation benefits. (See 10 U.S.C. 1174(h).)

Veterans do not receive separation pay for personal injuries or sickness (section 104(a)(4)

of the Code). Therefore, they cannot get a refund of the taxes they paid on separation pay even if the VA later determines that they qualify for disability compensation for the same period (section 104(a)(4) of the Code). (See *Palm v. United States*, 904 F. Supp. 1312 (M.D. Ala. 1995); *Berger v. Commissioner*, 76 T.C. 687, 693-94 (1981); and Rev. Rul. 80-9, 1980-1 C.B. 11.)

I hope this information is helpful. If you have further questions, please contact me or
(Identification Number) at () .

Sincerely,

LYNNE CAMILLO
Chief, Employment Tax Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)