



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

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CONEX-123168-08

The Honorable William D. Delahunt
Member, U.S. House of Representatives
1250 Hancock Street, Suite 802N
Quincy, MA 02169

Attention:

Dear Congressman Delahunt:

I am responding to your letter dated May 8, 2008, on behalf of your constituent, . asked if he is entitled to a refund of federal income tax withheld on a lump-sum disability severance payment he received from the Defense Finance and Accounting Service (DFAS) before the Department of Veterans Affairs (VA) determined that he was entitled to receive disability pay.

Whether we can refund income tax withheld on disability severance pay (DSP) depends on whether the DSP was excludable from gross income under section 104(a)(4) of the Internal Revenue Code (the Code). Amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country are excludable from gross income [Section 104(a)(4) of the Code]. The exclusion in section 104(a)(4) will apply to an individual if he or she would be entitled to receive disability compensation from the VA [Section 104(b)(2)(D) of the Code]. The amounts excludable under section 104(a)(4) may not be less than the amount the individual would be entitled to receive from the VA as disability compensation for the respective period [Section 104(b)(4) of the Code].

In 1991, a federal district court decided *St. Clair v. United States*, 778 F. Supp. 894 (1991). In that case, a Physical Examination Board (PEB) determined that a service member had a physical disability that warranted separation from military service. After the PEB's determination, the service member was discharged with disability severance pay issued to him in one lump-sum payment. The following year, the VA verified the

service member was entitled to VA benefits equal to the lump-sum amount. The court held that the lump-sum amount was excludable under section 104(a)(4) of the Code. Based on the court's decision in *St. Clair*, we adopted the position that a military member who receives a lump-sum disability severance payment and who is later awarded VA disability benefits may exclude the lump-sum amount from income under section 104(a)(4).

Given that the lump-sum amount _____ received is excludable from gross income, he can claim a refund of the withheld income tax. He can claim a refund by filing an amended return on Form 1040X, Amended U.S. Individual Income Tax Return. Taxpayers must file a claim for refund of an overpayment of tax within 3 years from the time they filed the return or 2 years from the time they paid the tax, whichever is later.

I hope this information is helpful. If you have any questions, please contact me or

at _____ .

Sincerely,

Nancy J. Marks
Associate/Division Counsel