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

May 1, 2009

Number: **INFO 2009-0093**  
Release Date: 6/26/2009

CC:TEGE:EOEG:ET2  
CONEX-117876-09

UIL: 112.00-00

The Honorable Charles Grassley  
United States Senator  
150 First Avenue, NE  
Cedar Rapids, IA 52401

Attention:

Dear Senator Grassley:

I am responding to your e-mail of March 24, 2009, requesting guidance on the taxability of back pay a World War II veteran received for service while he was a prisoner of war.

In 2001, the Congress provided that the Secretary of the Navy must make a payment of back pay to individuals who were not available to accept promotions because they were interned as prisoners of war while serving as members of the Navy or the Marine Corps during WW II [section 667(c) of the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (Public Law 106-398) (the 2001 Act)]. This payment represented the difference between the amount the prisoners of war would have received if they were able to accept the promotion and the amount of basic pay actually received during the period they were unable to accept the promotion.

In 2008, the Congress amended the law to provide for an increase in the back pay amount to reflect increases in the cost of living since the date the basic pay was awarded [section 675 of the National Defense Authorization Act for Fiscal Year 2008 (Public Law 110-181) (2008 Act)].

Military pay members of the United States Armed Forces receive is generally includable in gross income [section 1.61-2(a) of the Income Tax Regulations].

However, certain "qualified military benefits" are excluded from gross income [section 134 of the Internal Revenue Code (the Code)]. The term "qualified military benefit" means any allowance or in-kind benefit (other than personal use of a vehicle) that:

- Any member or former member of the uniformed services of the United States or dependent of such member receives because of the member's status or service as a member of the uniformed services; and
- Was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice in effect on such date (other than a provision of this title).

Because the Congress did not establish the benefits payable under section 675 of the 2008 Act until 2008, they cannot fit into the definition of "qualified military benefit" provided in section 134 of the Code. Accordingly, the payment is not excludible from income under section 134.

Compensation received for active service as a member below the grade of commissioned officer in the Armed Forces of the United States while serving in a combat zone is excluded from gross income under section 112(a) of the Code. A similar exclusion exists for commissioned officers in the Armed Forces, but the exclusion is limited to a certain amount of compensation per month [section 112(b) of the Code].

Because the Congress added section 112 to the Code in 1954, it does not apply to combat zone compensation earned for service during WW II. Rather, the governing Code provision is section 22(b)(13) of the 1939 Code, which provided a similar exclusion for combat zone compensation. While we were not asked about the federal income tax consequences of back pay awarded under the 2001 Act, it would likely meet the requirements for exclusion as pay earned in a combat zone.

Unfortunately, however, the cost of living adjustment under the 2008 Act does not fit within the definition of nontaxable combat zone compensation. Although the payments under the 2008 Act are related to service in a combat zone, they are really payments to reflect increases in the cost of living since the period the military member was imprisoned and therefore unable to accept a promotion for which he had been selected. As such, the payments are not for service in a combat zone and these payments are taxable.

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

Sincerely,

Nancy J. Marks  
Division Counsel/Associate Chief Counsel  
(Tax Exempt & Government Entities)