



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

OFFICE OF THE CHIEF COUNSEL

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Dear _____ :

I am writing in response to your letter dated February 9, 2011. In that letter you asked about excluded military retired pay under section 122 of the Internal Revenue Code (the Code). While I cannot address your particular situation in detail, I am providing the following general information concerning section 122 of the Code, which I hope will be helpful to you.

Section 122 of the Code excludes from the gross income the amount by which a member or former member of the military reduces his or her retainer or retired pay in order to obtain benefits for his or her survivors under the Survivor Benefit Plan or the Retired Serviceman's Family Protection Plan. Section 122 does not exclude any other amounts from gross income.

Section 104(a)(4) of the Code excludes 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. Subsection (D) of section 104(b)(2) provides that section 104(a)(4) will apply to an individual if, on application therefor, he would be entitled to receive disability compensation from the Veterans' Administration (VA).

A military retiree may elect an amount of pay based on percentage of disability or years of service [10 U.S.C. §§ 1401, 1402]. If an individual elects an amount of pay based on years of service, their retired pay is fully taxable. No part of the retired pay is attributable to personal injury or sickness for active service in the armed forces and no part of the retired pay can be excluded under section 104(a)(4). Conversely, if an individual retires from the military because of disability, a portion of their retired pay is

attributable to personal injury or sickness and is excludible under section 104(a)(4). The remaining amount is taxable income.

Additionally, a military retiree may apply to the VA for compensation for service-connected disabilities. However, the VA disability rating does not determine an individual's status for retirement from the United States Armed Forces. Thus, an individual who retires on the basis of years of service fixes the character of the payments he receives as compensation for length of service, rather than as compensation for or on account of disability; hence they are not excludable from income [Johnson v. Commissioner, T.C. Memo. 1977-367].

The Treasury Regulations provide the order in which various reductions in gross retired pay will be deducted in computing net taxable retired pay where there are multiple reductions pursuant to different statutory provisions. According to section 1.122-1 of the Regulations, net taxable retired military pay is computed by first reducing gross retired pay by amounts excluded under section 122(a) (amounts waived to receive benefits under the Survivor Benefit Plan of Retired Serviceman's Family Protection Plan), then reduced by the amount of retired pay waived to receive compensation from the VA, then reduced by retired pay excluded under section 104(a)(4) of the Code (amounts attributable to personal injury or sickness resulting from active service in the armed forces) less retired pay waived to receive VA compensation (but not to exceed the amount excluded under section 104(a)(4)).

Generally, nontaxable amounts of military retired pay and VA disability compensation are not reported on Form 1099-R. Thus, military retirees should receive a Form 1099-R each year which shows only the net taxable portion of their military retired pay after the reductions described above have already been made from their gross retired pay.

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

Sincerely,

Lynne Camillo
Branch Chief, Employment Tax Branch 2
(Exempt Organizations/ Employment Tax/
Government Entities)
(Tax Exempt and Government Entities)