



DEFENSE FINANCE AND ACCOUNTING SERVICE
U.S. Military Retired Pay
8899 E 56th Street
Indianapolis, IN 46249-1200
www.dfas.mil/retiredmilitary.html

Month XX, 20XX

, (Ret)

Dear :

St. Clair Decision
(Taxability of Disability Severance Pay)

Members who have been transferred to the Temporary Disability Retired List (TDRL), and who are not otherwise eligible for retirement, and whose final disability rating is less than 30%, may be discharged with disability severance pay.

These payments, when made to members who entered military service after September 24, 1975, are considered taxable entitlements. The only tax-exempt payments are those made to members who entered service prior to that date or who were transferred to the TDRL for a combat-related injury or illness.

In most disability retirements, the member is in concurrent receipt of Department of Veterans Administration Compensation. In these cases, a dollar-for-dollar reduction occurs against retired pay. The same principle applies to the receipt of severance pay. If the member is later discharged from the TDRL with severance pay, the same offset occurs with the Department of Veterans Affairs (VA) withholding compensation pay from the member until such time as the severance pay is recouped.

In 1991, the United States District Court ruled that disability severance pay received for personal injury resulting from active service in the armed forces is excludable from taxable income for members who are awarded VA compensation for the same disability.

Affected members who paid taxes on disability severance payments are entitled to a refund of Federal taxes withheld from their severance pay entitlement. In order to claim this refund they must file income tax returns to recover the taxes.

Since it can take in excess of six months or more to receive this tax refund from the IRS. Moving forward, Defense Finance and Accounting Service (DFAS-HQ) has established a policy to provide financial relief for affected members who have not yet received their disability

severance pay, by not withholding Federal taxes from an otherwise taxable payment. However, Military Retired Pay is still required to report to the IRS, the severance pay as fully taxable.

For a member to take advantage of this policy, member must provide to Military Retired Pay, copies of their VA Award Letter that notifies the member of his/her VA Compensation Award and the medical conditions relating to it. A copy of the member's letter from his/her service's Physical Evaluation Board (PEB) findings, which lists the member's medical conditions, must also be provided to Military Retired Pay. They then will compare the descriptions of the disabilities listed on both of these letters to see if at least one of the existing medical conditions exactly match.

The member must provide to Military Retired Pay, both the VA Award Letter and the PEB findings before the end of the tax year, which is before the end of the December work month of each year.

Members who do not submit the required documentation before the end of the tax year (after the end of the December work month of each year) will need to direct their inquiry to their local Internal Revenue Service (IRS) office. The member will then need to provide to the IRS the disability information (copies of their VA Award Letter and the PEB findings) at the time he/she files their Federal tax return. The IRS will refund the Federal tax as appropriate. Please be advised that at least one of the existing medical conditions must exactly match.

We thank you for your service to our country. If you have any further questions, you can contact one of our customer care representatives at 800-321-1080 or 216-522-5955, between 8:00 a.m. 5:00 p.m., Eastern Standard Time, Monday through Friday, or write to us at the address above.

Sincerely,

Military Pay Technician
Retired and Annuitant Pay