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Recoupment of Disability Severance Pay From Disability Compensation,

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Text:

Recoupment of Disability Severance Pay From Disability Compensation

QUESTIONS PRESENTED:

A. Whether 10 U.S.C. §§ 1212(c) requires the Department of Veterans Affairs (VA) to deduct the gross amount" of military disability severance pay (DSP) or the net amount of DSP after Federal taxes from any VA disability compensation payments the veteran receives for the same disability.

B. Whether 38 U.S.C. § 5301 (formerly § 3101)¹ requires VA to take into account Federal tax paid on DSP in determining the amount which is subject to deduction under the provisions of 10 U.S.C. § 1212(c).

COMMENTS:

1. It is our opinion that the recoupment provision of section 1212(c) requires VA to deduct the gross amount" of DSP which includes the amount withheld for taxes, from any disability compensation payments the veteran receives for the same disability. Moreover, the tax exemption provisions of 38 U.S.C. § § 5301 are inapplicable to DSP payments, and VA may not take into account Federal tax paid on DSP in determining the required deduction from disability compensation payments.

2. Section 1212(c) of title 10, United States Code, specifically requires VA to deduct the amount of military DSP a veteran receives from any disability compensation for the same disability which VA may award the veteran. See also 38 C.F.R. § § 3.700(a)(3). 10 U.S.C. § 1212(c) provides that:

The amount of disability severance pay received under this section shall be deducted from any compensation for the same disability to which the former member of the Armed Forces, or his dependents, become entitled under any law administered by the Veterans Administration. However, no deduction may be made from any death compensation to which his dependents become entitled after his death.

The deduction of military disability severance pay from VA disability compensation

¹ The Department of Veterans Affairs Health-Care Personnel Act of 1991, Pub. L. No. 102-40, § 402(b)(1), 105 Stat. 187, 238 (1991) redesignated each section in, among other chapters, chapters 53 and 61 of title 38, United States Code, so that the first two digits of the section number are the same as the chapter number of the chapter containing that section.

prevents the duplication of payments and ensures that the veteran is not paid twice for the same disability. See In re Newman, 35 Bankr. 97, 98 (Bankr.W.D.N.Y.1983); see also 38 U.S.C. § 5304 (formerly § 3104).

3. Prior to 1976, disability severance pay was excluded from gross income under section 104 of the Internal Revenue Code, title 26, United States Code, and therefore, was not subject to Federal taxation. See S.Rep. No. 938, 94th Cong., 2d Sess. 138, reprinted in 1976 U.S.Code Cong. Admin.News 2897, 3571. In 1976, Congress amended section 104 to terminate the exclusion and to make DSP subject to Federal taxation for veterans who were not in service on or before September 24, 1975, and who did not have a disability based on a combat-related injury". 26 U.S.C. § 104(b). The purpose of the amendment was to end a perceived abuse of disability retirement pay" by retired military veterans by treating combat-related disabilities differently from other disabilities. See S.Rep. No. 938, 94th Cong., 2d Sess. 138-39, reprinted in 1976 U.S.Code Cong. Admin.News 2897, 3571-72. As a result of the amendment, the amount of DSP received by a veteran who enters military service after September 24, 1975, and whose disability is not based on a combat-related injury," as defined in section 104, is counted as income for Federal taxation purposes and is subject to income tax withholding.

4. As noted in your memorandum requesting our opinion, fractional recovery by VA from monthly disability compensation payments of an amount equal to 75 percent of the lump-sum readjustment payments received under former 10 U.S.C. § 687 was authorized, in order to take into account the tax paid on the original payment and to avoid recoupment of an amount in excess of the net received as readjustment pay." S.Rep. No. 1096, 87th Cong., 1st Sess. 4; Undigested Opinion, 11-1-78; see also Rev.Rul. 80-9, 1980-1 C.B. 11 (Congress limited the recoupment to 75 percent of the readjustment pay so as to avoid recoupment of an amount in excess of the net amount after tax received by a taxpayer, assuming an average tax bracket of 25 percent."). The express statutory authority in former 10 U.S.C. § 687 to recoup an amount of VA disability compensation equal to 75 percent of the lump-sum readjustment payment is implemented in 38 C.F.R. § 3.700(a)(2).²

5. There is no analogous statutory provision authorizing VA to recoup a fractional amount from disability compensation payments to take into account the tax paid on a veteran's DSP. Without similar express statutory authority, VA simply does not have the authority to adjust the recoupment from the veteran's disability compensation payment to account for Federal income tax paid on DSP. Accordingly, a veteran who receives DSP and who is subject to the provisions of 26 U.S.C. § 104(b) cannot receive VA disability compensation until VA has recouped an amount equal to the gross amount of the disability severance pay. See 10 U.S.C. § 1212(c); 38 C.F.R. § 3.700(a)(3).

² 10 U.S.C. § 687 was repealed in 1980 by Pub. L. No. 96-513 § 109(a), 94 Stat. 2870 and was replaced by 10 U.S.C. § 1174 which does not provide statutory authority for VA to recoup an amount of VA disability compensation equal to a fractional amount of lump-sum readjustment payment.

6. In response to the question whether 38 U.S.C. § 5301 requires VA to take into account the Federal tax paid on the DSP in determining the amount which is subject to the deduction under the provisions of 10 U.S.C. § 1212(c), we find section 5301 inapplicable to such determinations. The exemption from taxation provided by 38 U.S.C. § 5301(a) applies only to [p]ayments of benefits due or to become due under any law administered by the [Department of Veterans Affairs]." DSP which is received by a veteran under 10 U.S.C. § 1212(a) is not a benefit under VA laws, and therefore, DSP payments are not exempt from taxation pursuant to 38 U.S.C. § 5301(a). Moreover, in light of the explicit deduction required by 10 U.S.C. § 1212(c), the provisions of section 5301(a) are inapplicable and they do not exempt DSP payments from Federal taxation under 26 U.S.C. § 104(a). See Berger v. Commissioner, 76 T.C. 687 (1981) (Veteran is not entitled to recharacterize the readjustment pay as disability compensation excludable from gross income under section 104(a)(4), 1954 Internal Revenue Code, and 38 U.S.C. § 5301(a)).

7. In the present case, the veteran entered active military service in February 1977, after September 24, 1975, when DSP was made subject to Federal income taxation pursuant to 26 U.S.C. §§ 104(b). VA subsequently rated him eligible for disability compensation payments for the same disability (back disorder) for which he received the military DSP. Apparently, the veteran's disability was not based on a combat-related injury," as defined in 26 U.S.C. §§ 104(b)(3), and the veteran's DSP was subject to Federal income taxes. In view of the foregoing explanation, the provisions of 10 U.S.C. § 1212(c) and 38 C.F.R. § 3.700(a)(2) require VA to deduct the gross amount" of the DSP payment, including the amount withheld for taxes, from the veteran's disability compensation payments.

8. We realize this outcome may be perceived as harsh. It must be recognized, however, that, in 1976 when Congress amended 26 U.S.C. § 104 to make DSP taxable, it also amended the section to provide that even if veterans do not actually receive disability benefits from VA they may exclude from their gross incomes amounts equal to the benefits they could receive from VA. S.Rep. No. 938, 94th Cong., 2d Sess. 139, reprinted in 1976 U.S.Code Cong. Admin.News 2897, 3572. Thus, veterans faced with this situation may be able to avoid the seemingly harsh tax consequences of their receipt of DSP. However, such tax issues are beyond the purview of the Department of Veterans Affairs, and involve questions for resolution, at least initially, by the Internal Revenue Service (IRS) and, perhaps ultimately by the courts. See Rev.Rul. 80-9, 1980-1 C.B. 11 (IRS holds that a taxpayer who receives retroactive disability compensation from VA may not exclude from gross income under section 104(a)(4) of the Internal Revenue Code any part of a lump-sum readjustment payment since readjustment pay is not a series of periodic payments); but see Strickland v. Commissioner, 540 F.2d 1196 (4th Cir.1976) (Court holds that a taxpayer who receives retroactive disability compensation from VA may exclude under section 104(a)(4) of the Internal Revenue Code retirement pay during the retroactive period equal to the amount attributable to the VA disability compensation).

HELD:

A. A veteran who receives military disability severance pay under 10 U.S.C. § 1212(c) cannot receive VA disability compensation until VA has recouped an amount equal to the gross amount" of the disability severance pay.

B. The disability severance pay which is received by the veteran under 10 U.S.C. § 1212(a) is not a benefit under VA laws, therefore, the disability severance pay is not exempt from taxation pursuant to 38 U.S.C. § 5301(a).