

INTERNAL REVENUE SERVICE

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November 18, 1999

Taxpayer =

Dear

This responds to your letter of June 21, 1999, requesting a ruling that your military retirement pay is excludable from your gross income under section 104(a)(4) of the Internal Revenue Code (the "Code").

The facts as we understand them are as follows. You retired from the armed forces and received military retirement pay based on years of service from the Department of Defense (DOD). You also elected a survivor benefit. You subsequently applied to the Veterans Administration (VA) for disability benefits. The VA determined that you have an overall combined disability rating of 90 percent. You have elected to waive your DOD years of service retirement benefits to the extent of your VA benefits so that you could receive the VA benefits tax free.

Since your retirement in 1968, you have received annual Forms 1099R from the DOD reporting a portion of your retirement pay as taxable income. However, it is your position that you were retired for permanent disability with a 40 percent disability rating from DOD and not for years of service and, therefore, your entire retirement benefit should be fully nontaxable.

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 of any country.

Section 104(b)(2)(A) of the Code provides that section 104(a)(4) will apply to an individual if, on or before September 24, 1975, he was entitled to receive an amount described in section 104(a)(4).

10 U.S.C. 1401(b) provides that military retirement pay will be the greater of the amount computed on the basis of years of service or percentage of disability.

Section 1.104-1(e) of the Income Tax Regulations states that for purposes of section 104(a)(4), that part of the retired pay of a member of an armed force, computed under formula No. 1 or 2 of 10 U.S.C. 1401, or under 10 U.S.C. 1402(d), on the basis of years

of services, which exceeds the retired pay that he would receive if it were computed on the basis of percentage of disability is not considered as a pension, annuity, or similar allowance for personal injury or sickness, resulting from active service in the armed forces.

Section 1.122-1 of the regulations provides that in computing the amount of net taxable retirement pay, gross retired pay is reduced in the following order: (1) the cost of the survivor benefit election; (2) the amount of any VA compensation award for which retired pay is waived; and (3) the amount by which retired pay computed on the basis of any DOD disability rating percentage exceeds the amount waived for VA compensation.

Accordingly, the portion of your retirement benefit that exceeds the sum of your survivor benefit cost and the greater of the amount of your VA compensation or the amount of any DOD retirement pay based on percentage of disability is taxable. Thus, even if you were retired for permanent disability with a 40 percent disability rating, a portion of your retirement pay may nevertheless be includable in income. The information provided is not adequate for us to determine whether the computation of the taxable amount made by DOD in your case is correct.

Except as specifically ruled upon above, no opinion is expressed or implied with respect to the application of any other provisions of the Code or the regulations to the benefits described. Specifically, no ruling is intended or implied with respect to whether the computation of your taxable retirement pay made by DOD is correct.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Harry Beker
Chief, Branch 6
Office of the Associate Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosures

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