

#57 AMEND THE COMBAT-INJURED VETERANS TAX FAIRNESS ACT OF 2016 TO ALLOW VETERANS OF THE COAST GUARD TO FILE CLAIMS FOR CREDIT OR REFUND FOR TAXES IMPROPERLY WITHHELD FROM DISABILITY SEVERANCE PAY

Present Law

IRC § 61(a)(1) provides that compensation for services is includable in gross income. Severance payments generally are treated as compensation and therefore subject to taxation.

IRC § 104(a)(4) provides an exclusion from gross income for payments received for personal injuries or sickness resulting from active service in the armed forces.

IRC § 104(b)(2) clarifies that the exclusion from gross income in IRC § 104(a)(4) applies to an amount received by reason of a combat-related injury, or if the individual, upon application, would be entitled to receive disability compensation from the Department of Veterans Affairs. IRC § 104(b)(3) defines “combat-related injury.”

To obtain a credit or refund, a taxpayer must file a timely claim. IRC § 6511(a) provides generally that a taxpayer must file a claim for credit or refund within 3 years from the time the tax return was filed or 2 years from the time the tax was paid, whichever period expires later.

In 2016, Congress passed the Combat-Injured Veterans Tax Fairness Act (the “Act”).¹⁹⁵ In a findings section, the Act states: “Since 1991, the Secretary of Defense has improperly withheld taxes from severance pay for wounded veterans, thus denying them their due compensation and a significant benefit intended by Congress.” Recognizing that the period of limitation for filing a claim for credit or refund to recover overwithheld tax had long since expired for most tax years since 1991, the Act created an exception from the general period of limitation.

Specifically, the Act directed the Secretary of Defense (i) to identify disability severance pay (DSP) that was not considered gross income pursuant to IRC § 104(a)(4) and from which the Secretary improperly withheld tax and (ii) to send notices to all affected veterans notifying them of their eligibility to receive credits or refunds and providing instructions for filing amended tax returns. It further provided that veterans who received DSP from the Department of Defense may file timely claims for credit or refund within one year from the date of the notice sent by the Secretary of Defense or by the date the period of limitations described in IRC § 6511(a) expires, whichever is later.

IRC § 7701(a)(15) defines the terms “military or naval forces of the United States” and “Armed Forces of the United States” to include “all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force [as well as] the Coast Guard.”

Reasons for Change

Notwithstanding that the IRC’s definition of “military or naval forces of the United States” includes the Coast Guard, the Act was drafted in a manner that excludes veterans of the Coast Guard from its scope. More specifically, Section 3(a) of the Act directed the Secretary of Defense to identify DSP paid after January 17, 1991, that should have been excluded from gross income, but it did not direct the Secretary of Homeland

¹⁹⁵ Pub. L. No. 114-292, 130 Stat. 1500 (2016).

Security, to whom the Coast Guard reports, to identify affected Coast Guard veterans and DSP amounts from which taxes were withheld.

The result is that similarly situated Coast Guard veterans with combat-related injuries are not eligible for the relief provided by this Act. We believe the exclusion of Coast Guard veterans was inadvertent and that members of the Coast Guard should be provided the same additional time to file a claim for credit or refund as other veterans of the “military or naval forces of the United States.”

Recommendation

Amend Section 3(a) of the Combat-Injured Veterans Tax Fairness Act of 2016 to require the Secretary of Homeland Security to notify veterans of the Coast Guard about disability severance pay from which taxes were withheld, and provide that the severance payments specified under Section 3(a) include those paid by the Secretary of Homeland Security (or predecessor) to allow veterans of the Coast Guard to file claims for refund or credit for one year from the date of the notification.