

**VOLUME 7B, CHAPTER 24: “COMPUTATION OF WAGES SUBJECT TO
FEDERAL INCOME TAX WITHHOLDING”**

SUMMARY OF MAJOR CHANGES

All changes are denoted by **blue font**.

Substantive revisions are denoted by an * symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by **bold, italic, blue and underlined font**.

The previous version dated January 2010 is archived.

| PARAGRAPH | EXPLANATION OF CHANGE/REVISION | PURPOSE |
|------------------|--|----------------|
| All | Verified hyperlinks, formatting, and references. | Update |
| Bibliography | Added references to support text written in corresponding sections and paragraphs. | Add |

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CHAPTER 24

**COMPUTATION OF WAGES SUBJECT TO FEDERAL INCOME TAX
WITHHOLDING**

2401 BACKGROUND

Federal income tax withholding (FITW) is based on payments actually or constructively paid, regardless of date on which they are earned. Retired pay is paid constructively when it is credited to the account or set apart for a retiree so that he or she may draw on it at any time, although it is not actually reduced to possession. It must have been credited to or set apart for the retiree without any substantial limitation or restriction as to the time or manner of payment or condition under which it is to be made and brought within the retiree's control and disposition.

2402 RETIRED PAY SUBJECT TO FITW

Except as otherwise indicated in this chapter, retired pay is income and constitutes wages subject to FITW.

2403 RETIRED PAY NOT SUBJECT TO FITW

240301. Gross Retired Pay Not Subject to FITW

The gross retired pay of a member is not subject to FITW if the member's retired pay is computed only on the basis of percentage of disability and the member is on the temporary or permanent disability retired lists, if:

A. On or before September 24, 1975, the member was entitled to receive retired pay computed on the basis of percentage of disability ([26 United States Code \(U.S.C.\), subparagraph 104\(a\)\(4\)](#) and [104\(b\)\(2\)\(A\)](#));

B. On September 24, 1975, he or she was a member of the Armed Forces (or Reserve Component thereof) or under a binding written commitment to become such a member ([26 U.S.C. 104\(a\)\(4\)](#) and [104\(b\)\(2\)\(B\)](#)); or

C. The member receives disability retired pay because of a combat-related injury. The term "combat-related injury" means personal injury or sickness incurred as a direct result of armed conflict, or while engaged in extra hazardous service, or under conditions simulating war, or caused by an instrument of war.

2404 EFFECT OF [VETERANS AFFAIRS \(VA\)](#) AWARD ON FITW

A member is entitled to exclude from the taxable portion of retired pay:

240401. Disability Compensation

The maximum amount that he or she would be entitled to receive as disability compensation upon application to the Department of VA.

240402. Additional Amount

An additional amount based on the difference between a prospective VA disability compensation award and the amount excluded under section 2403.

240403. Retroactive Disability Compensation

The retroactive amount of a VA disability compensation award not previously excluded from retired pay.

2405 GROSS PAY PARTIALLY TAXABLE

Part of the retired pay for members who are entitled to have their retired pay computed on the basis of both percentage of disability and years of service may be designated as FITW wages. Any reduction of FITW wages for disability retired pay must meet one of the conditions set forth in section 2403.

240501. Post September 30, 1949

Compute the FITW wages of members retired for disability on or after October 1, 1949 as follows:

A. If the member is placed on the Permanent Disability Retired List, then subtract retired pay based on the percentage of disability from retired pay based on the years of service. The result of such subtraction is FITW wages.

B. If the member is placed on the Temporary Disability Retired List, then use one of these two methods:

1. If the member's disability rating is 50 percent or more, then compute as in subparagraph 240501.A.

2. If the member's disability rating is less than 50 percent and retired pay is computed based on years of service, then exclude from FITW wages the amount of retired pay the member would have received if such pay were computed solely on the actual percentage of disability. If the member's disability rating is less than 50 percent and the member elects to receive disability retired pay based on the percentage of disability, then the retired pay received is not FITW wages.

240502. Before October 1, 1949

FITW wages for members who retired before October 1, 1949 fell into two

categories. Such retired pay was either based on years of service and was fully taxable or it was based on disability and was nontaxable. Members retired for physical disability before October 1, 1949 were assigned a disability rating for purposes of computing retired pay entitlement under the provisions of the Career Compensation Act. These members could either continue to receive the nontaxable retired pay they were receiving on September 30, 1949 or elect to receive retired pay computed under the provisions of the Career Compensation Act based on the percentage of disability assigned or years of active service. If members chose to have their pay computed based on the Career Compensation Act, then their FITW wages were computed as described in section 2403 or subparagraph 240501.A.

2406 FITW WAGE REDUCTIONS FROM DEDUCTIONS AND COLLECTIONS

Deductions and collections that reduce FITW wages include:

240601. Participate in Retired Serviceman's Family Protection Plan (RSFPP)

The total reduction of a member's retired pay in order to participate in the RSFPP. This deduction did not reduce taxable income until the tax laws were changed to permit a dollar-for-dollar reduction effective January 1, 1966. The tax implication for a member who pays for this protection by direct remittance is discussed in section 2411.

240602. Participate in Survivor Benefit Plan (SBP)

The total reduction of a member's retired pay to participate in the SBP. The tax implication for a member who pays for this protection by direct remittance is discussed in section 2410.

240603. VA Compensation

Waiver of pay because a member is receiving compensation or a pension from the VA.

A. If the member's gross retired pay is fully subject to FITW, then subtract the amount of the VA waiver from FITW wages.

B. In the case of a member retired because of physical disability, reduce FITW wages, if any, by the amount of the VA waiver or the portion of the member's retired pay based on the actual percentage of disability, whichever is greater.

2407 UNITED STATES CITIZENS ABROAD

The retired pay of members who temporarily or permanently reside in a foreign country is subject to FITW as if they resided in the United States or its possessions. Thus, apply the withholding rules discussed in section 2402.

2408 ARREARS OF PAY

See Chapter 30, section 3003 of this volume for taxation policies that apply to deceased members and their beneficiaries.

2409 COLLECTION OF DELINQUENT TAXES

240901. Voluntary Withholding

A retiree may, with the consent of the Internal Revenue Service (IRS), have deductions made from his or her retired pay to satisfy a debt due to tax delinquency. The class T allotment has been designated to allow a member to make payments to IRS in this manner.

240902. Involuntary Withholding

If a retiree neglects or refuses to pay his or her Federal income tax liability within 10 days after receiving notice of liability, then the cognizant IRS District Director can collect the amount by placing a levy on the member's retired pay. The IRS is required to give the member 10 days notice that a levy will be executed. This notice normally is included with the notification of liability. See Chapter 28 of this volume for more information.

2410 TAXABILITY OF SBP/RSFPP PREMIUMS

241001. Premiums

Premiums deducted from retired pay for SBP/RSFPP will reduce taxable retired pay.

241002. Premiums Paid by Direct Remittance

When the retired pay account of a SBP/RSFPP participant is placed in a suspended status, the retiree is required to pay the monthly premiums by direct remittances. For any year in which such a retiree receives taxable retired pay, a certificate may be issued to report any remittances not previously reported which were received through the end of the year. The member may then reduce the reported taxable retired pay when he files the tax return. If the member does not receive taxable retired pay and then subsequently dies, a certificate will be issued to the annuitant for all remittances made not previously reported on a certificate.

2411 PROCESSING CORRECTION OF RECORDS CASES

If payment is made as the result of a correction of military records, then that payment is processed as follows:

241101. Amounts Previously Paid and Reported

When amounts previously paid and reported as FITW wages are not subject to FITW as a result of the correction, the member is provided either a corrected IRS Form 1099-R for the 3

calendar years before the year that the correction action is made or a letter citing the “before” and “after” amounts for each calendar year involved. The member then may obtain a tax refund, if any is due, from the IRS based on his or her total tax liability for 3 years. In accordance with 52 Comp. Gen. 420 (1973), a claim for the refund of income taxes paid in years prior to the 3-year period may be treated as a claim for pecuniary benefits under [10 U.S.C. 1552](#) and paid pursuant to the record correction.

241102. Retired Pay Subject to FITW

When the member’s retired pay is subject to FITW, the payment is reported as FITW wages from applicable current year appropriations reserved for such payment.

2412 TAXABILITY AND WITHHOLDING OF DISABILITY SEVERANCE PAY

See Volume 7A, Chapter 35, paragraph 350404 of this Regulation.

2413 TAXABILITY OF RETIRED PAY FOR FLEET RESERVIST/FLEET MARINE CORPS RESERVIST NOT PHYSICALLY QUALIFIED FOR RETENTION IN THE FLEET RESERVE/FLEET MARINE CORPS RESERVE (FR/FMCR)

The retired pay of a member of the FR/FMCR who is transferred to the retired list, when found not physically qualified for retention in the FR/FMCR (as stated in Chapter 2, paragraph 020102 of this volume) is subject to FITW.

