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

SUMMARY OF MAJOR CHANGES

All changes are denoted by blue font.

Substantive revisions are denoted by an asterisk (*) 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 August 2017 is archived.

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<td>240202</td>
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<td>240202.C</td>
<td>Added note to subparagraph for clarification.</td>
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CHAPTER 24

COMPUTATION OF WAGES SUBJECT TO FEDERAL INCOME TAX WITHHOLDING (FITW)

2401 GENERAL

240101. Purpose

The purpose of this chapter is to provide information on retired pay subject to FITW. FITW is based on payments actually or constructively paid, regardless of the 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.

240102. Authoritative Guidance

The pay policies and requirements established by the Department of Defense (DoD) in this chapter are derived primarily from, and prepared in accordance with the United States Code (U.S.C.), including Title 26. Due to the subject matter in this chapter, the list of authoritative sources is extensive. The specific statutes, regulations, and other applicable guidance that govern each individual section are listed in a reference section at the end of the chapter.

2402 RETIRED PAY SUBJECT TO FITW AND NOT SUBJECT TO FITW

240201. Gross Retired Pay Subject to FITW

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

*240202. Gross Retired Pay Not Subject to FITW

The gross retired pay of a member may not be subject to FITW if the member is on the Temporary Disability Retired List (TDRL) or Permanent Disability Retired List (PDRL), receiving disability retired pay and if:

A. On or before September 24, 1975, the member was entitled to receive retired pay computed on the basis of percentage of disability pursuant to Title 26, U.S.C., sections 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));
*  **C.** The member is receiving 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, pursuant to 26 U.S.C. §§ 104(a)(4) and 104(b)(2)(C). This determination is made by the applicable Service at the time of discharge. See DoD Instruction (DoDI) 1332.18; or

NOTE: The amount of disability retired pay described in subparagraph 240202.C not subject to FITW is the amount related to the combat-related injury, but in no circumstances will the nontaxable amount be less than the amount the member would be entitled to receive from the Department of Veterans Affairs (VA) for that injury.

*  **D.** The member would be entitled to disability compensation from the VA pursuant to 26 U.S.C. §§ 104(a)(4) and 104(b)(2)(D). For those members who have waived all or a portion of their retired pay in order to receive an award from VA, subtract the VA waiver from the gross retired pay to compute the member’s taxable income. Subtract the VA waiver prior to subtracting other income reducing amounts, such as Survivor Benefit Plan (SBP) premiums. For members who are receiving retired pay based upon their years of service but who have a portion of their retired pay that is tax exempt due to their retirement for disability under Chapter 61 of Title 10, taxable pay is determined by reducing the gross retired pay by the VA entitlement or the retired pay that would be exempt due to the percentage of disability, whichever is greater.

2403 **EFFECT OF DISABILITY COMPENSATION AWARD ON FITW**

A member is entitled to exclude the disability compensation, additional amount, and retroactive disability compensation from the taxable portion of retired pay.

240301. Disability Compensation

Disability compensation is the maximum amount that a member would be entitled to receive upon application to the VA.

240302. Additional Amount

An additional amount is the difference between a prospective VA disability compensation award and the amount excluded under section 2402.

240303. Retroactive Disability Compensation

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

2404 **GROSS PAY PARTIALLY TAXABLE**

For members who are entitled to have their retired pay computed based on both percentage of disability and years of service, a portion of their retired pay may be subject to FITW. Any
reduction of wages subject to FITW for disability retired pay must meet one of the conditions set forth in paragraph 240202.

*240401. Post September 30, 1949

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

A. If the member is placed on the PDRL, subtract retired pay based on the percentage of disability from retired pay based on the years of service. The result of such subtraction is the amount of wages subject to FITW.

B. If the member is placed on the TDRL, use one of these methods:

1. If the member’s disability rating is 50 percent or more, compute as in subparagraph 240401.A.

2. If the member’s disability rating is less than 50 percent on the TDRL and the member is receiving retired pay computed based on years of service, subtract the amount of retired pay the member would have received if retired pay were computed solely on the basis of the member’s actual percentage of disability from the gross retired pay the member is receiving. The result of the subtraction is the amount of wages subject to FITW.

3. If a member with 20 years or less of service is placed on the TDRL and 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, the retired pay received is not subject to FITW.

240402. Before October 1, 1949

The wages subject to FITW 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, their wages subject to FITW were computed as described in paragraph 240202 or subparagraph 240401.A.

2405 FITW WAGE REDUCTIONS FROM DEDUCTIONS AND COLLECTIONS

Deductions and collections that reduce the amount of wages subject to FITW include participation in Retired Serviceman’s Family Protection Plan (RSFPP), participation in SBP, and VA Disability Compensation.
240501. Participation in Retired Serviceman's Family Protection Plan (RSFPP)

The amount of the member’s retired pay subject to FITW is reduced by the full amount of the RSFPP costs deducted from the 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 2409.

240502. Participation in Survivor Benefit Plan (SBP)

The amount of the member’s retired pay subject to FITW is reduced by the full amount of the SBP costs deducted from the member’s retired pay in order to participate in the SBP. The tax implication for a member who pays for this protection by direct remittance is discussed in section 2409.

240503. Veterans Affairs (VA) Disability Compensation

There is a waiver of military retired pay when a member receives disability compensation or a pension from the VA.

Note: If a member is entitled to concurrent retirement and disability pay on or after January 1, 2014, the waiver provision does not apply.

A. If the member’s gross retired pay is fully subject to FITW, subtract the amount of the VA waiver applied to wages. The VA waiver reduces the member’s retired pay entitlement.

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

2406 U.S. 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 in section 2402.

2407 ARREARS OF PAY

See Chapter 30 for taxation policies that apply to deceased members and their beneficiaries.
2408 COLLECTION OF DELINQUENT TAXES

240801. 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 the IRS in this manner.

240802. 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, 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.

*2409 TAXABILITY OF SBP/RSFPP PREMIUMS

240901. Premiums

SBP/RSFPP premiums are deducted from retired pay which reduces the retiree’s taxable income.

240902. Premiums Paid by Direct Remittance

SBP/RSFPP premiums paid by direct remittance will be deposited into the Treasury as miscellaneous receipts and will not reduce the retiree’s taxable income.

2410 PROCESSING CORRECTION OF RECORDS CASES

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

241001. 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, Distributions From Pension, Annuities, Retirement or Profit-Sharing Plans, Individual Retirement Accounts, Insurance Contracts, etc., 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 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 Comptroller General 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.
241002. 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.

2411 TAXABILITY AND WITHHOLDING OF DISABILITY SEVERANCE PAY

See Volume 7A, Chapter 35.

2412 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, subparagraph 020101.B), is subject to FITW.
*REFERENCES

CHAPTER 24 - COMPUTATION OF WAGES SUBJECT TO FEDERAL INCOME TAX WITHHOLDING (FITW)

2402 – RETIRED PAY SUBJECT TO FITW AND NOT SUBJECT TO FITW

240201 Title 26, Code of Federal Regulations (CFR), part 31.3401(a)-1(b)

26 U.S.C. § 104(b)
26 U.S.C. § 104(b)(2)(A)

26 U.S.C. § 104(b)(2)(B)

240202.C DoDI 1332.18, August 5, 2014

240202.D 26 U.S.C. §§ 104(a)(4) and 104(b)(2)(D)

2403 – EFFECT OF DISABILITY COMPENSATION AWARD ON FITW

26 U.S.C. § 104(b)(4)

240303 Strickland v. Commissioner of Internal Revenue, 540 F2d 1196(1976)

2404 – GROSS PAY PARTIALLY TAXABLE

240401 26 CFR 1.104-1

240402 Career Compensation Act of 1949, Public Law 351, 81st Congress, 63 Stat 802

2408 – COLLECTION OF DELINQUENT TAXES

240802 26 U.S.C. § 6331

2409 TAXABILITY OF SBP/RSFPP PREMIUMS

10 U.S.C. § 1448(g)(5)
REFERENCES (Continued)

2410 – PROCESSING CORRECTION OF RECORDS CASES

|        | 52 Comptroller General, 420 (1973) |
|        | 10 U.S.C. § 1552 |