



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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Dear _____ :

This letter is in response to your inquiry dated September 1, 2010. You asked about the Net Disability Tax Exclusion and whether you qualify to take advantage of this exclusion.

Military personnel, or former military personnel, who make an election under the Retired Serviceman's Family Protection Plan [United States Code Title 10 Section 1431], or the Survivor Benefit Plan [United States Code Title 10 Section 1447] to receive a reduced amount of retirement pay (or retainer pay) to provide annuities for their survivors can exclude from gross income any reduction in retirement or retainer pay resulting from the election [section 122 of the Internal Revenue Code (the Code)]. In addition to reductions in retirement pay for survivor benefits, these individuals can exclude from gross income any part of their retirement pay that they receive on account of personal injuries or sickness [section 104(a)(4) of the Code].

The Income Tax Regulations relating to section 122 of the Code provide the order in which various reductions (including Retired Serviceman's Family Protection Plan or Survivor Benefit Plan reductions) in gross retired pay will be deducted in computing net taxable retired pay where there are multiple reductions pursuant to different statutory provisions. If an amount is excludible from income under both section 122 (as a result of an election to reduce retirement pay to fund a survivor annuity) and section 104(a)(2) as a disability payment, the section 122 exclusion applies [Reg. § 1.122-1(c)(2)]. If the retired military member waives part of a disability payment for a benefit under the laws administered by the Veterans Administration [38 U.S.C. § 3105], the section 122 exclusion is applied before the other exclusions [Reg. § 1.122-1(c)(3)].

As outlined in the Regulations, the Net Disability Tax Exclusion refers to:

- Excludable retired pay computed under section 104(a)(4) of the Code (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)
- Less: Retired pay, not to exceed the amount of excludable retired pay under section 104(a)(4) of the Code, waived to receive V.A. compensation.

The amount of the Net Disability Tax Exclusion, as well as other calculations described in section 1.122-1(c) of the Regulations, is then used to determine net taxable retired pay.

The calculation described above only applies if you make an election under the Retired Serviceman's Family Protection Plan or the Survivor Benefit Plan [Reg. § 1.122-1(c)(1)].

I hope this information is helpful. If I can assist you further, please contact me or
at .

Sincerely,

Lynne Camillo
Branch Chief, Employment Tax Branch 2
(Exempt Organizations/ Employment Tax/
Government Entities)
(Tax Exempt & Government Entities)