




Lesson 16 – Military Income





About Lesson 16 – Military Income

- Additional resources listed in L< “References” tab
- Review all tips and cautions in the lesson
- Read all examples and sample interviews
- We will review answers to each exercise



Objectives Lesson 16 – Military Income

Determine:

- Which income items received by members of the U.S. Armed Forces are reportable on the tax return
- The status of any medical separation pay or pay related to service in a combat zone
- Time Required: 30 minutes

Topics



- Includible and Excludable Income
- Medical Separation Pay
- Combat Zone Exclusion
- Community Property



Key Terms

Definitions are always available in the L< online Glossary.

- Active Pay
- BAH
- BAS
- Combat Zone
- Letter of Determination
- Medical Severance Pay
- OHA
- SSB
- VA Disability Compensation



Includible and Excludable Income

- What is the difference between includible and excludable income?
 - Includible items are subject to tax and must be reported on the tax return
 - Excludable items are not subject to tax, but may have to be shown on the tax return
- Includible:
 - As listed in [Pub 4012](#), Tab D, Income, Armed Forces Gross Income
 - Generally shown in box 1 of Form W-2
- Excludable:
 - Furnished in-kind (given in goods, commodities, or services rather than money) or
 - A reimbursement or an allowance (such as BAH)

Medical Separation Pay

- 100% of disability severance benefit is excluded from income.
- Disability payments come directly from the VA and are not listed on Form W-2 or any other document because they are exempt from federal and state income tax.





Combat Zone Exclusion

- Combat pay is indicated by code Q on Form W-2, box 12.
 - Review L< for understanding of when pay is excludable, but you will not need to make decisions about what is excludable.
- Excludable payment must be earned or accrued (not necessarily received) during a month the Armed Forces member served in a combat zone.
- Nontaxable combat pay may increase the Child Tax Credit or the Earned Income Tax Credit.
 - Compare the credit with and without the inclusion of combat pay; choose the one that is most beneficial to the taxpayer.

Community Property

- Special rules apply to married persons who file separate returns or who were divorced during the tax year and were domiciled in a community property state.
 - Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin
- What is a domicile?
 - Someone's legal, permanent residence, not always where the person *presently* lives.
- For more information, see [Pub 555](#), Community Property.





Out of Scope for this Lesson:

- U.S. Armed Forces members who were provided a commuter highway vehicle (such as a van) by their employer.



Summary

- Some items received by members of the Armed Forces are included in their gross income, while other items are excluded from income. Includible military income is generally the amount shown in box 1 of Form W-2.
- For discharged service members, VA disability payments offset taxable pension payments, and are exempt from taxes.
- Pay for service in a combat zone is not taxed for an enlisted member of the U.S. military.
- State community property laws apply to active military pay.