

## ***De Paolis v. Commissioner, 69 T. C. 283 (1977)***

Disability retirement payments received before mandatory retirement age do not qualify for the retirement income credit under section 37 of the Internal Revenue Code of 1954.

### **Summary**

In *De Paolis v. Commissioner*, Thomas A. DePaolis, a retired Air Force lieutenant colonel, sought a retirement income credit under section 37 of the Internal Revenue Code for his disability retirement payments received in 1972. The key issue was whether these payments, received before mandatory retirement age, qualified as “retirement income.” The Tax Court held that they did not, reasoning that such payments were considered “wages or payments in lieu of wages” under section 105(d), not “pensions or annuities” under section 37. This decision was based on the interpretation that pre-mandatory retirement age disability payments are not “retirement income” for tax credit purposes, despite the literal language of section 37, due to the overarching structure of the tax code and policy against double benefits.

### **Facts**

Thomas A. DePaolis, an Air Force officer, retired on physical disability with a 10% disability rating in 1967 at the age of 49, before reaching the mandatory retirement age for a lieutenant colonel. He received \$9,130 in disability payments in 1972 and claimed a retirement income credit of \$268 under section 37 of the Internal Revenue Code. DePaolis also claimed a sick pay exclusion of \$5,200 under section 105(d). The Commissioner disallowed the retirement income credit, asserting that the payments were not “retirement income” as defined in section 37.

### **Procedural History**

The Commissioner determined a deficiency in DePaolis’s federal income tax for 1972, which led to DePaolis filing a petition with the United States Tax Court. The Tax Court, in a majority opinion, upheld the Commissioner’s determination and denied the retirement income credit. Judges Fay, Tannenwald, Hall, and Drennen dissented, arguing that the payments should be considered “retirement income” under section 37.

### **Issue(s)**

1. Whether disability retirement payments received by a military officer before reaching mandatory retirement age qualify as “retirement income” under section 37 of the Internal Revenue Code of 1954.

### **Holding**

1. No, because such payments are considered “wages or payments in lieu of wages” under section 105(d) and thus do not fall within the definition of “pensions and annuities” under section 37.

### **Court’s Reasoning**

The majority opinion, authored by Judge Dawson, reasoned that disability payments received before mandatory retirement age are governed by section 105(d) as “wages or payments in lieu of wages,” not as “pensions and annuities” under section 37. The court relied on Revenue Ruling 69-12, which stated that disability annuities received by federal employees before normal retirement age do not qualify as retirement income under section 37. The court noted that the legislative history aimed to treat military and civilian retirees similarly, suggesting that disability payments should not qualify for the credit. The majority also expressed concern about allowing a “double tax benefit” by permitting a taxpayer to claim both a sick pay exclusion and a retirement income credit. The dissenting opinions, led by Judges Fay and Hall, argued that the majority’s interpretation was an example of judicial legislation, as there was no statutory support for excluding disability payments from the definition of “retirement income. “

### **Practical Implications**

The De Paolis decision impacts how tax practitioners should analyze disability retirement payments received before mandatory retirement age. It clarifies that such payments do not qualify for the retirement income credit, preventing taxpayers from claiming both a sick pay exclusion and a retirement income credit. This ruling may influence how retirement systems and employers structure benefits to avoid unintended tax consequences. Future cases involving similar issues may need to distinguish between disability payments and regular retirement payments to determine tax credit eligibility. The decision also highlights the importance of legislative clarity in defining terms like “pensions and annuities” to prevent judicial interpretation that may deviate from statutory intent.