Berger v. Commissioner, 76 T. C. 687, 1981 U. S. Tax Ct. LEXIS 138 (1981)

Military readjustment pay is fully taxable as income and cannot be reclassified as nontaxable disability compensation.

Summary

William Berger, discharged from the U. S. Army due to a reduction-in-force, received $14,511 in readjustment pay. Later, he was awarded a 10% disability rating by the Veterans' Administration, which would reduce his disability compensation by 75% of the readjustment pay. Berger argued that 75% of his readjustment pay should be reclassified as nontaxable disability compensation. The U. S. Tax Court held that the entire readjustment pay was taxable income under Section 61(a) of the Internal Revenue Code, and it could not be retroactively reclassified as disability compensation under Sections 104(a)(4) and 38 U. S. C. 3101(a).

Facts

William Berger was discharged from the U. S. Army on September 10, 1973, after over 6 years of service due to a reduction-in-force program. He received $14,511 in readjustment pay. Subsequently, on January 16, 1974, Berger received a 10% disability rating from the Veterans' Administration, entitling him to disability compensation, but subject to a deduction of 75% of the readjustment pay he had received. On his 1973 tax return, Berger reported only a portion of the readjustment pay as taxable income, treating 75% as nontaxable disability compensation.

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency to Berger, asserting that the entire readjustment pay was taxable. Berger contested this in the U. S. Tax Court, arguing that 75% of the readjustment pay should be considered nontaxable disability compensation. The Tax Court upheld the Commissioner's position, ruling that the readjustment pay was fully taxable.

Issue(s)

1. Whether Berger is entitled to exclude from his 1973 gross income any portion of the readjustment pay he received from the U. S. Army upon his involuntary discharge, by reclassifying it as disability compensation under Sections 104(a)(4) and 38 U. S. C. 3101(a).

Holding

1. No, because the readjustment pay received by Berger is fully includable in his gross income under Section 61(a) of the Internal Revenue Code, and cannot be reclassified as disability compensation under Sections 104(a)(4) and 38 U. S. C. 3101(a).

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Court’s Reasoning

The court applied Section 61(a) of the Internal Revenue Code, which broadly defines gross income as “all income from whatever source derived. ” The court noted that Congress had not specifically exempted readjustment pay from taxation. Berger’s argument for reclassification was rejected because Sections 104(a)(4) and 38 U. S. C. 3101(a) do not relate to readjustment pay. The court distinguished the case from *Strickland v. Commissioner*, where the taxpayer had waived a portion of retirement pay for disability compensation. Berger had no such waiver and received the full readjustment pay without restriction. The court also considered the legislative history of readjustment pay, which did not support its reclassification as disability compensation. The court concluded that the readjustment pay was taxable when received, and subsequent disability compensation did not retroactively change its tax status.

Practical Implications

This decision clarifies that military readjustment pay is taxable and cannot be retroactively reclassified as nontaxable disability compensation. Legal practitioners should advise clients receiving readjustment pay to report it as taxable income. The ruling may influence how veterans plan their finances upon discharge, particularly those expecting future disability compensation. Subsequent cases involving similar issues would likely follow this precedent, reinforcing the tax treatment of readjustment pay. This decision also underscores the importance of understanding the specific tax implications of various types of military payments, guiding attorneys in advising their veteran clients on tax planning and compliance.

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