UNITED STATES TAX COURT
WASHINGTON, DC 20217

ANTHONY SEAN MARTINEZ,	)	
	)	
Petitioner,	)	
	)	
v.	)	Docket No. 14383-15.
	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
	)	
Respondent	)	

O R D E R

This case has been tried and briefed, but we will order the parties to file supplemental briefs.

The issue remaining for decision in this case is whether the lump-sum payment that petitioner Anthony Martinez received from the Air Force in 2012 was excludible from taxable income under section 104(a)(4) and (b)(2). The Commissioner argues it was not. The Commissioner's opening brief (ECF 14) states at 9 that:

> The total [lump-sum] retirement benefit paid to petitioner by DFAS was computed pursuant to 10 U.S.C. § 1203 and compensated petitioner based on his years of military service and his pay grade.

(See also reply brief (ECF 20) at 13.) Evidently, the pertinent subsection of 10 U.S.C. section 1203 is (b)(4)(A), which refers to circumstances in which the disability was "the proximate result of performing active duty".

As in his pretrial memorandum (ECF 7 at 8-9), the Commissioner states in his opening brief (at 20):

> Respondent agrees that petitioner received the lump-sum retirement distribution "as a pension, annuity, or similar allowance for personal

> injuries or sickness resulting from active service in the armed forces of any country." See St. Clair v. United States, 778 F.Supp. 894 (1991), acq. 1992-06, 1991 WL 772483.

As indicated by the St. Clair citation, the Commissioner's statement in his brief is consistent with his acquiescence to the opinion in that case, which held that where an Air Force Staff Sergeant "was discharged with disability severance pay in accordance with" 10 U.S.C. section 1203, and "the Veterans Administration (the VA) verified that [he] had suffered a 10% disability while he was on active duty ... and determined that [he] was entitled to VA disability benefits for the same," 778 F.Supp. at 895 (emphasis added), the disability severance pay was excluded from taxable income.

The St. Clair opinion does not cite section 104(b)(2) or explain how it was satisfied in that case, but we note that the St. Clair language we underscore above (i.e., "entitled to VA disability benefits for the same") echoes section 104(b)(2)(D), which allows the application of section 104(a)(4) where the taxpayer "would be entitled to receive disability compensation from the Veterans' Administration" (emphasis added). Cf. Reimels v. Commissioner, 124 T.C. 245, 256-57 (2004) (discussing section 104(b)(4), rather than 104(b)(2)(D)). Of course, Mr. Martinez is "entitled to receive disability compensation from the Veterans' Administration" and does receive it.

We note a similar economy of expression and citation in Internal Revenue Manual ("IRM"), part 21.6.6.4.20.2 (12-09-2014), which follows St. Clair and provides in relevant part:

> (1) Veterans who are separated from military service due to medical or disability reasons generally receive severance pay.... Public Law 104-201, Section 653(b) provides that once the veteran receives a determination letter from the Department of Veterans Affairs (VA) awarding a retroactive disability rating, the disability severance payment received upon discharge becomes nontaxable.

Like the St. Clair opinion, the IRM does not cite section 104(b)(2) but implies that the income exclusion inquiry ends with a VA determination of disability. That implication is borne out in the instructions that follow in the IRM:

> (2) To claim the severance payment as nontaxable (a "St. Clair" claim ...), the veteran must submit the VA Determination letter

> confirming the disability and the Defense Finance and Accounting Services (DFAS) letter or Form DD214 confirming the amount of the lump sum disability severance payment and that the taxpayer was discharged due to disability as provided under 10 U.S.C. 1203.... [Emphasis added.]

IRS Publication 4491 ("VITA/TCE Training Guide") gives at page 17-3 an example that follows that approach: A "service member who was separated due to a medical condition" (with no indication of combat-relatedness as in section 104(b)(2)(C)) and who receives (among other things) "Disability severance pay [of] $10,000 ... can ... exclude ... the entire $10,000 disability severance payment".

In this case, however, the IRS contends that, because the Air Force found that Mr. Martinez's injury was not combat-related, the lump-sum benefit payment is not excludible, despite his having received a disability determination from the VA. This contention is arguably at odds with St. Clair, the Commissioner's Action on Decision acquiescing to it, the IRM provisions cited here, and Publication 4491. But a distinction from St. Clair is suggested in respondent's opening brief (at 36-37):

> Whereas St. Clair received his VA disability rating after receiving the lump-sum, petitioner received his rating before. Id. at 895. In St. Clair's case, assuming that subsections 104(b)(2)(A) through (C) were not met, whatever VA benefits he forewent between receiving his lump-sum retirement benefit in 1988 and his VA disability rating in 1989 would be excludable from income, since he forewent those benefits between his severance from the military and receiving his VA rating.

This seems to give a possible reason that a portion of an initially taxable lump-sum severance payment might be recharacterized as non-taxable after the VA's disability rating (i.e., to retroactively assure the tax-free character of the past VA benefit); but we do not see this reasoning being hinted at in St. Clair. Rather, in St. Clair, in the IRM, and in Publication 4491, the obtaining of the VA disability rating results in non-taxability for the entire severance payment. If so, we do not yet see any reason for denying the income exclusion simply because the VA issued its disability rating before the Air Force paid the lump sum, rather than after.

We do not insist that these sources are binding precedents, but we would like to know whether we misunderstand these sources, or whether the Commissioner

limits his acquiescence in St. Clair and disclaims these materials, or whether there is some reason that the Commissioner deliberately takes in litigation an approach different from the approach he seems to take in the administration of section 104(a)(4).

It is therefore

ORDERED that, no later than November 13, 2017, the Commissioner shall file a supplemental brief that (1) comments on the foregoing and (2) states whether the Commissioner disputes that the UAVs and the video equipment by which their operators view their effects are "instrumentalit[ies] of war" for purposes of section 104(b)(3)(B). It is further

ORDERED that, no later than December 4, 2017, Mr. Martinez may file a supplemental brief.

(Signed) David Gustafson
Judge

Dated: Washington, D.C.
October 12, 2017