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TAXES AND MILITARY PENSIONS

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5.0—Military service and family obligations

6.0—Military service and tax laws

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Direct Payments When Possible

In a military divorce case, the nonmilitary spouse will often be concerned about pension share payments and taxes. She (It is usually but by no means always the wife.) will invariably want to receive pension division payments directly from the retired pay center. For the Army, Navy, Air Force and Marine Corps, this is DFAS (Defense Finance and Accounting Service) in Cleveland, Ohio. Pension garnishments for the Coast Guard and the commissioned corps of the Public Health Service and of the National Oceanic and Atmospheric Administration are handled by the Coast Guard Pay and Personnel Center in Topeka, Kansas.

In the usual case, attempts to get the hypothetical service member, Colonel John Doe, to write a monthly pension share check to his ex-wife once he has retired may be an exercise in futility. Suppose he retires in another state? What if his retirement residence is in Germany or Japan? If he retires elsewhere, or if he insists on moving around from place to place, it will be virtually impossible for the former spouse to collect her share each month.

Direct pension payments by garnishment benefit COL Doe as well as his ex-wife. He needs to know that, with a garnishment, the military does the appropriate withholding before sending out checks. The ex-wife's share of his military pension is automatically excluded from his taxable income. He receives (as she does) a Form 1099-R each January showing what the

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taxable income is for the prior tax year. He doesn't need to keep track of writing a check every month to send it to his former spouse.

When Direct Payments Are Not Possible

But sometimes it is not possible to obtain payments through the military retired pay center. Pension garnishment payments for property division cannot be made through the pay center when there is not a 10-year overlap of the marriage and the period of creditable service.² In addition, there will be another gap of up to 90 days at the start of the pension garnishment process, to account for review and processing of the military pension division order (MPDO).³

When the retired pay center does not make direct payments to the former spouse, Colonel John Doe will need to make the payments to his ex-wife directly. He will have tax withheld on the entire amount that he received. He can exclude from his income any amount he paid her pursuant to the decree or agreement. His ex-wife is liable for taxes on the share of the pension that she received, and she should include the payments in her gross income.⁴

How to Do It

How is this done? The payor's payment may be entered as a negative number at Line 21 on Form 1040 as "Other income," or a negative at Line 16a, "Pensions and annuities" or at Line 31a, "Alimony paid."⁵ He should, of course, attach to the tax return an explanatory note, along with appropriate documents.

What about income for the recipient? John Doe's ex-wife will complete her own Form 1040 and this would show the payments which she received from Colonel Doe, pursuant to a written instrument, which are the division of this defined benefit program. She would reflect the gross amount paid to her by John under "Pensions and annuities," which is line 16a.

To cover these contingencies, consider a clause in the court order or settlement document that says:

Periodic payments made by Husband directly to the Wife which are not done by garnishment through the military retired pay center will be included in Wife's income under Sections 61 and 71 of the Internal Revenue Code, and these payments are likewise excludable from Husband's from his gross income.

² 10 U.S.C. § 1408(d)(2).

³ *Id.*

⁴ *Pfister v. Comm'r*, 359 F.3d 352 (4th Cir. 2004), *aff'g*, T.C. Memo. 2002-198; *Proctor v. Comm'r*, 129 T.C. 12 (2007); *Mitchell v. Comm'r*, T.C. Summary Opinion 2004-160; *Weir v. Comm'r*, 82 T.C.M. 281 (2001); *Baker v. Comm'r*, T.C. Memo 2000-164; *Mess v. Comm'r*, T.C. Memo 2000-37; *Eatinger v. Comm'r*, T.C. Memo 1990-310.; and *Lowe v Comm'r*, 42 T.C.M. 334 (1981).

⁵ *See, e.g.*, Bruce M. Bird and Marcia Sakai, "Structuring Payments as Deductible Alimony" *The CPA Journal* (New York Society of CPAs), August 2008.

At the end of this paragraph, the drafting attorney may choose to insert the citations shown herein as authority for this clause.

On a related tax note, don't forget to advise your clients about the possible deduction of legal fees for work done on obtaining a portion of the military pension for them. After all, the pension payments are taxable income for the former spouse. And the legal work was done, and fees paid, toward the production of taxable income.⁶ Be sure to counsel your client, the former spouse, to ask her tax preparer as to whether this is a deductible expense and, if so, how much may legitimately be claimed as a deduction.

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⁶ Reg 1.162-2(b)(7): "Generally, attorney's fees and other costs paid in connection with a divorce, separation, or decree for support are not deductible by either the husband or the wife. However, the part of an attorney's fee and the part of the other costs paid [by the wife] in connection with a divorce, legal separation, written separation agreement, or a decree for support, which are properly attributable to the production or collection of amounts includible in gross income under section 71 are deductible by the wife under section 212."