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H.B. 18
133rd General Assembly

Final Analysis

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Version: As Passed by the General Assembly

Primary Sponsors: Reps. Vitale and Crawley

Effective date: May 26, 2020

Mackenzie Damon, Attorney

UPDATED VERSION*

SUMMARY

- Authorizes an income tax deduction for all disability severance pay received by an honorably discharged veteran.
- Allows a taxpayer who is eligible for an Ohio income tax refund based on disability severance pay that was erroneously taxed at the federal level to apply for the refund even if the statutory deadline has passed, so long as the taxpayer requests the refund by December 31, 2020.

DETAILED ANALYSIS

Disability severance pay

The act exempts all disability severance pay received by an honorably discharged veteran from Ohio's personal income tax. Under prior law, certain disability severance payments were exempt from taxation while others were not, depending on the circumstances under which the payments were made.

Disability severance pay is a one-time lump sum benefit received by a former member of the armed forces with a service-connected disability that is significant enough to prevent them from performing required duties but is not of a sufficient rating to activate eligibility for disability retirement (i.e., 30% or greater). Disability severance pay is computed by multiplying the veteran's years of service by two months of base pay.¹ It is taxable for federal income tax purposes unless one or more of the following apply:

* This version updates the effective date.

¹ 10 United States Code (U.S.C.) § 1212.

1. The veteran was enlisted before September 24, 1975;
2. The veteran's injury occurred in a terrorist attack or is combat-related – meaning it resulted directly from an armed conflict, took place while engaged in extra-hazardous service, took place under conditions simulating war (e.g., training exercises), or was caused by an instrumentality of war;
3. The veteran is entitled to receive disability compensation from the United States Department of Veterans Affairs (VA).²

Under the circumstance described in (3), above, the federal exemption is limited to the amount of disability compensation the veteran would have received from the VA. Disability compensation awarded by the VA is computed based on the veteran's disability rating and number of dependents. It is then offset by any amount the veteran received as disability severance pay. If the disability severance pay exceeds the amount of VA disability compensation to which the veteran would have been entitled, the remainder of the disability severance pay is taxable income.³

Ohio income tax

Ohio uses federal adjusted gross income (FAGI) as a starting point in computing Ohio taxable income for state income tax purposes. Therefore, if disability severance pay is exempt from the federal income tax, that exemption carries through to Ohio's income tax. Correspondingly, any such pay that is taxable at the federal level would also be taxable in Ohio, unless otherwise exempted by Ohio law.⁴

The act exempts all disability severance pay from Ohio income tax to the extent it would otherwise be taxable if the recipient is discharged or released from the armed forces under honorable conditions. Amounts received by such an individual in 2019 or thereafter may be deducted when computing the individual's taxable income.⁵

Combat-Injured Veterans Tax Fairness Act of 2016

In 2016, Congress passed the Combat-Injured Veterans Tax Fairness Act. This Act addressed erroneous taxation by the federal government of certain disability severance pay

² 26 U.S.C. § 104(a)(4), (a)(5), and (b)(2).

³ See *Internal Revenue Service Publication No. 525* (2018), pg. 18, available at: <https://www.irs.gov/pub/irs-pdf/p525.pdf>.

⁴ Under continuing law, Ohio allows veterans to deduct amounts received as "retired personnel pay" for service in the uniformed services, reserves, or National Guard. It is not clear whether certain federally taxable disability severance pay qualifies as retired personnel pay for this deduction – a case for qualification would have to overcome the legal principle that tax exemption statutes are strictly construed against the claimant. See, e.g., *Anderson/Maltbie Partnership v. Levin*, 127 Ohio St.3d 178, ¶ 16 (2010).

⁵ R.C. 5747.01(A)(34) and Section 3 of the act.

that should have been tax-exempt. It required the Secretary of Defense to notify veterans that received such a payment after January 17, 1991, that they may be eligible for a refund. The statute of limitations for claiming a federal tax refund with respect to those veterans also was extended.⁶

A veteran who receives a federal tax refund under the Combat-Injured Veterans Tax Fairness Act might also be eligible for an Ohio income tax refund. Generally, applications for refunds must be submitted within four years after the excessive tax payment or, if the refund arises from a change to the taxpayer's federal income tax liability, 90 days after the taxpayer's FAGI is finally determined. The act extends this latter deadline, for taxpayers whose change in federal tax liability relates to disability severance pay, to 180 days after the taxpayer's FAGI is finally determined.⁷

The act also explicitly allows a taxpayer who is eligible for an Ohio income tax refund based on the Combat-Injured Veterans Tax Fairness Act to claim that refund for any taxable year before 2019, even if the statutory deadline to file a refund application for that taxable year has passed, so long as the taxpayer requests the refund before December 31, 2020.⁸

HISTORY

Action	Date
Introduced	02-12-19
Reported, H. Ways & Means	03-20-19
Passed House (98-0)	03-27-19
Reported S. Ways & Means	12-17-19
Passed Senate (33-0)	12-17-19
House concurred in Senate amendments (94-0)	01-28-20

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⁶ H.R. 5015, 114th Congress (2016). In 1991, a federal district court found that a veteran's disability severance payment constituted an allowance for active service injury and therefore excluded from taxable income under 26 U.S.C. 104(a)(4). *St. Clair v. United States*, 778 F.Supp. 894.

⁷ R.C. 5747.10(B) and 5747.11(B), the latter section is not in the act.

⁸ Section 3 of the act.