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# OHIO LEGISLATIVE SERVICE COMMISSION

Office of Research  
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Legislative Budget  
Office

H.B. 18  
133rd General Assembly

## Bill Analysis

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**Version:** As Passed by the House

**Primary Sponsors:** Reps. Vitale and Crawley

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### SUMMARY

- Authorizes an income tax deduction for disability severance pay received by an honorably discharged veteran.
- Authorizes a temporary refundable income tax credit equal to the Ohio income tax paid by such a veteran on disability severance pay for taxable years ending after January 17, 1991.

### DETAILED ANALYSIS

#### Disability severance pay

The bill exempts disability severance pay received by an honorably discharged veteran from Ohio's personal income tax. 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.<sup>1</sup> It is taxable for federal income tax purposes unless one or more of the following apply:

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;

<sup>1</sup> 10 U.S.C. § 1212.

3. The veteran is entitled to receive disability compensation from the United States Department of Veterans Affairs (VA).<sup>2</sup>

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.<sup>3</sup>

## 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, the federal exemption for *some* disability severance pay carries through for Ohio's income tax under continuing law. In addition, Ohio allows veterans to deduct amounts received as "retired personnel pay" for service in the uniformed services, reserves, or National Guard.<sup>4</sup> It is not clear whether 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.<sup>5</sup>

The bill explicitly exempts disability severance pay from income tax if the recipient is discharged or released from the armed forces under honorable conditions. Amounts received by such an individual in taxable years ending after the bill's effective date would be deducted when computing the individual's taxable income.<sup>6</sup>

The bill also authorizes a temporary refundable credit for individuals who paid Ohio income tax on disability severance pay in a prior taxable year (ending after January 17, 1991). The credit equals the difference between the income tax actually paid and the amount of tax that would have been owed had the disability severance pay been deducted in computing taxable income. A taxpayer claiming the credit is required to submit documentation sufficient to prove they are entitled to the amount claimed. The credit may be claimed with returns filed for either of two taxable years – those ending in either 2019 or 2020.<sup>7</sup>

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

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

<sup>4</sup> R.C. 5747.01(A)(26).

<sup>5</sup> See, e.g., *Anderson/Maltbie Partnership v. Levin*, 127 Ohio St.3d 178, ¶ 16 (2010).

<sup>6</sup> R.C. 5747.01(A)(34) and Section 3 of the bill.

<sup>7</sup> Section 4 of the bill.

## Combat-Injured Veterans Tax Fairness Act of 2016

The time limitation of the bill's refundable credit for state income tax paid on previously received disability severance pay is consistent with the application date of the Combat-Injured Veterans Tax Fairness Act passed by Congress in 2016. The Act addressed improper taxation by the federal government of disability severance pay 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 Act also extends the statute of limitations for claiming a federal tax refund with respect to those veterans.<sup>8</sup>

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.<sup>9</sup> However, when there is an adjustment to a taxpayer's federal return, the refund application may be submitted later – within 60 days of the date the taxpayer's adjusted FAGI is finally determined or the date the federal refund is issued, whichever occurs first.<sup>10</sup> A taxpayer who is eligible for an Ohio income tax refund based on the Combat-Injured Veterans Tax Fairness Act appears to be permitted to claim the refund with or without the enactment of this bill since the claim would arise from an adjustment to the federal return, provided the taxpayer files an amended Ohio return.

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### HISTORY

Action	Date
Introduced	02-12-19
Reported, H. Ways & Means	03-20-19
Passed House (98-0)	03-27-19

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<sup>8</sup> 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.

<sup>9</sup> R.C. 5747.11(B), not in the bill.

<sup>10</sup> R.C. 5747.10(B), not in the bill.