



UNITED STATES HOUSE OF REPRESENTATIVES  
COMMITTEE ON GOVERNMENT REFORM — MINORITY STAFF  
SPECIAL INVESTIGATIONS DIVISION  
JUNE 2005

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**THE DISABLED VETERANS TAX IMPACTS THOUSANDS OF VETERANS  
IN HAWAII'S 2ND CONGRESSIONAL DISTRICT**

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PREPARED FOR REP. ED CASE

**The Disabled Veterans Tax Impacts Hundreds of Veterans in Hawaii’s 2nd Congressional District**

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**EXECUTIVE SUMMARY**

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Every year, hundreds of thousands of disabled military veterans pay a “Disabled Veterans Tax” that effectively forces them to give up their disability benefits from the Department of Veterans Affairs. At the request of Rep. Ed Case, this report analyzes the impact of this regressive tax on veterans in the 2nd Congressional District of Hawaii.

Under current law, veterans with 20 years of military service are entitled to receive retirement benefits from the Department of Defense. In addition, veterans who incurred service-related disabilities are entitled to receive disability compensation benefits from the Department of Veterans Affairs. If a veteran has both 20 years of military service and a service-related disability, however, the veteran’s military retirement benefit is reduced on a dollar-for-dollar basis by the amount the veteran receives in disability compensation. This reduction in the veteran’s retirement benefits is commonly known as the “Disabled Veterans Tax.” Effectively, the disability compensation received by these veterans is taxed at a 100% rate.

Congress passed legislation to address this problem in 2003. At the time, President Bush claimed that the legislation “resolved the issue,” while Republican leaders in the House claimed that the legislation “marked an end” to the Disabled Veterans Tax. Despite these promises, however, hundreds of thousands of veterans nationwide continue to pay the Disabled Veterans Tax.

This report analyzes of the effect of the Disabled Veterans Tax in the 2nd Congressional District. It finds that:

- **Thousands of veterans in Rep. Case’s district are subject to the Disabled Veterans Tax.** Over 4,500 veterans in Hawaii, including over 2,100 veterans in Rep. Case’s district, currently lose benefits due to the Disabled Veterans Tax. The tax costs veterans in the district \$10 million annually, an average of over \$4,600 each.
- **Most veterans who pay the Disabled Veterans Tax will never receive relief under current law.** The 2003 legislation passed by Congress will be slowly phased in over the next nine years. However, even after this legislation is fully phased in, over three-fourths of veterans in Rep. Case’s district will not receive relief from the Disabled Veterans Tax. Even in 2014, when the 2003 legislation is fully phased in, over 1,600 veterans in Rep. Case’s district will lose an estimated \$4.7 million in benefits to the Disabled Veterans Tax.
- **Legislation supported by Rep. Case would end the Disabled Veterans Tax.** Rep. Case has cosponsored the New GI Bill of Rights for the 21st Century Act (H.R. 2131). Passage of this bill would end the Disabled Veterans Tax for any veteran with over 20 years of military service, restoring full benefits to over 2,100 veterans in his district.

## THE DISABLED VETERANS TAX

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Disabled military retirees receive benefits through two agencies, the Department of Defense and the Department of Veterans Affairs.

Veterans who have served for at least 20 years in the military receive standard retirement benefits from the Department of Defense. These benefits are determined by multiplying 2.5% of the service member's final basic pay by the number of years of service. Thus, a service member who has served for 20 years would receive annual retirement benefits equal to 50% of his or her final basic pay. Presently, there are an estimated 1.4 million retired veterans who receive average retirement pay of \$22,000 annually.<sup>1</sup>

Veterans who have service-related disabilities also receive compensation through the VA. The goal of these payments is to compensate the injured veterans for the reduction in earnings capacity resulting from disabilities incurred during military service.<sup>2</sup> These payments are based on a scale of disability severity. This scale ranges from 10% disabled to 100% disabled. Average monthly disability payments ranges from approximately \$108 for a veteran with a 10% disability to \$2,299 for a veteran who was 100% disabled.<sup>3</sup>

Hundreds of thousands of retired service members qualify for both military retirement benefits and VA disability benefits. Until recently, however, an 1891 law barred "concurrent receipt" of both military retirement benefits and disability benefits. As a result, for veterans who received both military retirement benefits from DOD and disability benefits from the VA, military retirement benefits were reduced dollar-for-dollar for each dollar of VA disability benefits.<sup>4</sup>

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<sup>1</sup> Congressional Research Service, *Military Retirement: Major Legislative Issues* (May 9, 2005). In addition, retirees with less than 20 years service can also receive disability retirement benefits if they have either (1) completed at least 8 years of creditable military service and received a physical disability rating of 30% or greater from an evaluation board or (2) incurred a disability resulting from active duty. There are an estimated 100,000 of these service members currently receiving disability retirement.

<sup>2</sup> GAO, *Military and Veterans Benefits: Observations on the Concurrent Receipt of Military Retirement and VA Disability Compensation* (Mar. 2003) (GAO-03-575T). Additional benefits are paid to veterans who are at least 30% disabled and have dependents and to very severely disabled veterans who qualify for "special monthly compensation."

<sup>3</sup> VA, *Disability Compensation: 2005 Rates* (2005) (online at <http://www1.va.gov/OPA/fact/05comprates.html>).

<sup>4</sup> Disabled retirees can choose to have either their military retirement benefits reduced by the amount of their VA disability benefits, or their VA disability benefits reduced by the amount of their military retirement benefit. Because military retirement benefits are

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The result of this policy — known as “the Disabled Veterans Tax” — was that hundreds of thousands of disabled veterans were denied billions of dollars in benefits each year.

### LEGISLATIVE EFFORTS TO ELIMINATE THE DISABLED VETERANS TAX

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Congress attempted to reduce the impact of the disabled veterans tax in 2003. Democrats in Congress supported the Retired Pay Restoration Act (H.R. 303). This legislation would have immediately eliminated the prohibition on concurrent receipt of veterans' retirement and disability benefits for all veterans with 20 years of service.

Although this bill had broad support in Congress, Republican leaders instead supported legislation that was significantly more limited in scope. As part of the FY 2005 DOD Authorization bill, Republican leaders included a plan to slowly phase out the disabled veterans tax for a limited number of veterans.<sup>5</sup> Under this new law, veterans with disability ratings of 50% or more have a portion of the Disabled Veterans Tax eliminated each year, with full elimination occurring over a ten-year period (ending in 2014).

President Bush claimed that the legislation “resolved the issue of concurrent receipt for military retirees in a fair and responsible manner,”<sup>6</sup> while Republican leaders claimed that the plan “marked an end” to the Disabled Veterans Tax.<sup>7</sup>

Veterans groups were unhappy with the legislation, claiming that it was “not the answer.”<sup>8</sup> These groups had several concerns. Because of the long phase-in period, reductions of the tax are currently very small, and most veterans will not receive their full benefits until 2014. More important, the legislation does nothing for most veterans who have disabilities rated 50% or less, who comprise the vast majority of veterans who are currently paying the Disabled Veterans Tax.<sup>9</sup> In

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taxable, while VA disability benefits are not, the vast majority of retirees choose to reduce their military retirement benefits.

<sup>5</sup> *Vets Could Collect More Benefits*, Washington Post (Oct. 17, 2003).

<sup>6</sup> White House, *Statement on the House of Representatives Action on the Defense Authorization Conference Report* (Nov. 7, 2003).

<sup>7</sup> *House OKs Disability, Retirement Pay for Veterans*, Washington Times (Nov. 8, 2003) (quoting House Majority Whip Roy Blunt).

<sup>8</sup> American Legion, *Legion: Disability Tax Compromise Unsatisfactory* (Oct. 16, 2003).

<sup>9</sup> The 2003 legislation allowed all veterans who are disabled due to injuries sustained in combat (including those who are less than 50% disabled) to receive benefits known as

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fact, DOD data indicate that over 400,000 veterans who are currently paying the Disabled Veterans Tax will receive no benefits at all from the 2003 legislation

### **OBJECTIVE AND METHODOLOGY**

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This report was requested by Rep. Ed Case, who represents the 2nd Congressional District of Hawaii. Rep. Case requested this report in order to determine (1) the impact of the Disabled Veterans Tax on veterans in the district; and (2) the additional benefits that disabled veterans in the district would receive under legislation that he supports.

To conduct this analysis, the Special Investigations Division obtained and analyzed data from the Office of the Actuary of the Department of Defense. The database included zip code-level data on the total number of military retirees who are currently subject to the Disabled Veterans Tax. It also included data on the monthly cost of the tax. Separate data obtained from the DOD actuary included zip code-level data estimating the effect of the Disabled Veterans Tax in 2014, after the scheduled relief is fully phased in. Using these databases, the Special Investigations Division analyzed the impact of the Disabled Veterans Tax on the 2nd Congressional District.<sup>10</sup>

### **FINDINGS**

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#### **The Disabled Veterans Tax Affects Thousands of Veterans in Hawaii's 2nd Congressional District**

There are 13,600 veterans in Hawaii who receive military retirement benefits. Of these veterans, 4,555 veterans — 33% — also receive disability benefits from the VA and are subject to the Disabled Veterans Tax. The Disabled Veterans Tax costs these veterans \$1.7 million each month in lost disability benefits. This is equivalent to \$21.2 million annually, an average of over \$4,600 each.

In Rep. Case's district, there are 6,442 veterans who receive military retirement benefits. Of these veterans, 2,144 — 33% — also receive disability benefits from the VA and are still subject to the Disabled Veterans Tax. In the 2nd

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Combat Related Special Compensation. These benefits were designed to make up for some of the losses sustained by these veterans due to the Disabled Veterans Tax. However, the vast majority of veterans do not qualify for this benefit because their disabilities are not combat related.

<sup>10</sup> All data in the DOD database was available at the 5-digit zip code level. Because 5-digit zip codes can sometimes be split between two or more congressional districts, the analysis assumes that when a zip code is split between two districts, half of the impacted veterans in the zip code are in each congressional district. Similarly, when a zip code is split between three districts, one-third of the impacted veterans in the zip code are assumed to be in each congressional district

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Congressional District, the Disabled Veterans Tax costs veterans \$833,000 each month in lost disability benefits. This is equivalent to \$10 million annually. On a per-veteran basis, the Disabled Veterans Tax costs each of the 2,144 affected veterans in Rep. Case's district an average of \$4,661 annually.

### **Most Disabled Veterans Will Never Receive Benefits from Reductions in the Disabled Veterans Tax**

Congress passed legislation in 2003 that addressed the Disabled Veterans Tax. This legislation will be phased in slowly, so that even veterans who receive reductions in their Disabled Veterans Tax will not receive full benefits until 2014.

DOD data indicate that in 2014, when the Disabled Veterans Tax is reduced to the maximum extent allowed by the 2003 law, 3,475 Hawaii veterans will lose \$10.2 million in annual benefits due to the Disabled Veterans Tax. In Rep. Case's district, 1,612 veterans will pay an annual Disabled Veterans Tax of almost \$4.7 million. Both statewide, and in Rep. Case's district, three-fourths of veterans now paying the Disabled Veterans Tax will still be forced to pay the tax in 2014.

### **Legislation to Eliminate the Disabled Veterans Tax Would Have Significant Benefits in Hawaii's 2nd Congressional District**

Legislation cosponsored by Rep. Case, the New G.I. Bill of Rights for the 21st Century Act (H.R. 2131), would on January 1, 2006, eliminate the Disabled Veterans Tax for all retired veterans with at least 20 years of service. Passage of H.R. 2131 would result in a rapid increase in benefits for 4,555 veterans in Hawaii. These veterans would receive an increase in benefits of over \$21 million annually.

Within the 2nd Congressional District, passage of H.R. 303 would result in increased benefits for 2,144 veterans. These veterans would receive an increase in benefits of \$10 million annually. On a per-veteran basis, the affected veterans in Rep. Case's district would see an increase of over \$4,600 in annual benefits.

## **CONCLUSION**

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An 1891 law prevents most disabled veterans from receiving both military retirement and VA disability benefits. As a result, hundreds of thousands of military veterans are forced to pay the Disabled Veterans Tax, reducing their benefits by billions of dollars each year. Although Congress attempted to reduce the impact of the tax in 2003, the vast majority of disabled veterans received no help from the legislation that was signed into law. This analysis finds that 2,144 disabled veterans in Rep. Case's district are still forced to pay the Disabled Veterans Tax. Legislation cosponsored by Rep. Case would eliminate the Disabled Veterans Tax for these veterans.