

Federal Income Tax Withholding after Leaving the Military

Almost half of the unpaid taxes owed by current and retired federal employees are owed by retired military. Most often, this is simply because these retirees don't have a complete understanding of their tax obligation. This publication outlines some steps you can take to ensure you don't end up having a large tax bill after you leave the service.

Tax Withholding and Other Information.

Many retired military members are surprised at the amount of federal income tax they owe when they file their first tax return after retiring from the military. This happens because they move into a higher tax bracket as a result of having income from two sources (military retirement and civilian employment) and not having enough tax withheld. The problem is further complicated if their spouse also works or if they have income from other sources.

WHAT TO KNOW

Prior to leaving the military, you should complete Form W-4P (*Withholding Certificate for Pension or Annuity Payments*) to tell the Defense Finance & Accounting Service (DFAS) how much tax to withhold from your monthly retirement pay.

When you start a new job outside the military, your new employer is required to ask you to complete Form W-4 (*Employee's Withholding Allowance Certificate*) to determine how much tax they should withhold from each paycheck.

Some retirees confuse military retirement pay, which is taxable, with Veterans Administration (VA) Disability Compensation or other non-taxable VA benefits. If you are not sure whether your retirement income is fully taxable, do not select "exempt" on your withholding form until you check with the VA or DFAS. If "exempt" instead of receiving Form W-2 at the end of the tax year showing wages paid and taxes withheld, you will receive Form 1099-R from DFAS showing your taxable military retirement pay and the amount of tax withheld.

Although Form W-4 comes with line-by-line instructions, there are calculations and terms which may be confusing. While some employers may have employees in personnel or human resources departments who can help you to complete the form correctly, it is your responsibility, not your employer's, to make sure enough tax is withheld.

WHAT TO DO

It is very important that you have the correct amount of tax withheld from your paycheck, and from your monthly military retirement pay. If you have a working spouse or more than one job, a general rule of thumb is to figure the total number of allowances you are entitled to claim on all jobs using worksheets from only one Form W-4, claim that number of allowances on the W-4 for your highest paying source of income and claim zero allowances on your other Forms W-4.

WHERE TO GO FOR HELP

Since computing income tax withholding can be confusing, the Armed Forces Tax Council and the IRS jointly produced a short educational video. This 15-minute CD portrays steps taken by one military retiree to avoid a potential tax bill after getting a job in the civilian world. This video is available on the American Bar Association Web site and can be accessed at www.abanet.org by inserting "Federal Taxes after the Military" in the search block.

The IRS has a withholding calculator on its Web site that you can use in determining how much tax should be withheld. Many find the calculator easier to understand than the withholding form, since the calculator is interactive. It can be accessed by inserting "withholding calculator" in the search block at www.irs.gov.

WHAT TYPES OF INCOME ARE NONTAXABLE?

Some income is not subject to tax. A few examples are veteran's benefits, disability pay for certain military or government-related incidents, worker's compensation, and cash rebates from a dealer or manufacturer of an item you purchase.

FREQUENTLY ASKED QUESTIONS

Q. As a military retiree is my retirement pay taxable?

A. Payments you receive as a member of a military service generally are taxed as wages except for retirement pay, which is taxed as a pension. If your retirement pay is based on age or length of service, it is taxable and must be included in your income as a pension on lines 16a and 16b of Form 1040 or on lines 12a and 12b of Form 1040A. Do not include in your income the amount of any reduction in retirement or retainer pay to provide survivor annuity for your spouse or children under the Retired Serviceman's Family Protection Plan or the Survivor Benefit Plan.

For additional information, see Publication 525.

Q. I am a military retiree. Where can I go to change my retirement pay withholding?

A. There are two ways to change your military retirement pay withholding. You can call the Retiree Pay customer service number at DFAS at 1-800-321-1080. Or, you can make changes online via DFAS's myPay secure web-based pay management system. The myPay system lets active duty military, National Guard and Reserve members, some federal government civilian employees, and military retirees and annuitants quickly change pay information like federal and state withholding. If you are a myPay account holder, log in at <https://mypay.dfas.mil>. If you want to set up a new account or need help with your existing account, call the myPay Customer Service Center at 1-877-363-3677.

FOR ADDITIONAL INFORMATION

All of the following forms and publications can be found on the Internal Revenue Service Internet site (www.irs.gov).

If you have additional questions, the IRS also has a toll free number with personnel ready to help you. The number is 1-800-829-1040. Some IRS offices offer walk-in assistance and you can find out where these offices are located by calling the same toll free number.

Many of you may have received free tax filing assistance through the military Volunteer Income Tax Assistance (VITA) program. If you do not have access to this service after you retire, many community organizations also offer a level of free VITA tax assistance. To find a site convenient for you, simply call the IRS toll free number at 1-800-829-1040.

For a free paper copy of any listed form or publication, please call 1-800-829-3676 (1-800-TAX-FORM).

For additional questions about tax relief and your responsibilities, you can call 1-800-829-1040.

Some IRS offices offer walk-in assistance and you can find out where these offices are located by calling the same toll free number.

Forms and Publications that may be of assistance:

- Publication 501, Exemptions, Standard Deduction, and Filing Information
- Publication 505, Tax Withholding and Estimated Tax
- Publication 525, Taxable and Nontaxable Income
- Publication 554, Tax Guide for Seniors
- Publication 560, Retirement Plans for Small Business
- Publication 575, Pension and Annuity Income
- Publication 721, Tax Guide to U.S. Civil Service Retirement Benefits
- Publication 915, Social Security and Equivalent Railroad Retirement Benefits
- Publication 939, General Rule for Pensions and Annuities
- Form 1040, U. S. Individual Income Tax Return
- Form 1040A, U. S. Individual Income Tax Return
- Form 1040-ES, Estimated Tax for Individuals
- Schedule C, Profit or Loss From Business
- Schedule C-EZ, Net Profit From Business
- Schedule SE, Self-Employment Tax

FREE TAX RETURN ASSISTANCE

Many of you may have received free tax filing assistance through the military Volunteer Income Tax Assistance (VITA) program. If you do not have access to this service after you retire, many community organizations also offer a level of free VITA tax assistance.

Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) Sites offer free tax return preparation to individuals having low to moderate income. To find free tax help near you, call IRS at 1-800-829-1040 or AARP TaxAide at 1-888-227-7669.

