

## Important Notice: North Carolina Enacts New Deduction For Certain Military Retirement Pay and Survivor Benefit Plan Payments

The following important information is addressed in this notice:

- A brief introduction of North Carolina’s deduction for certain military retirement pay and Survivor Benefit Plan payments.
- A response to several frequently asked questions (“FAQs”) related to the new deduction. These FAQs are intended to provide general information to taxpayers and tax professionals. Accordingly, these FAQs may be updated or modified.

### Introduction

In November 2021, North Carolina enacted legislation that allows eligible retired members of the Armed Forces of the United States (“Armed Forces”) to deduct certain military retirement pay when calculating North Carolina taxable income beginning tax year 2021.<sup>1</sup> The law also allows eligible beneficiaries of the Survivor Benefit Plan (“SBP”) to deduct certain SBP payments beginning tax year 2021.

Generally, military retirement pay based on age or length of service is included in gross income and taxable for federal income tax purposes.<sup>2</sup> Likewise, benefit payments from the SBP are generally included in gross income and taxable for federal income tax purposes.<sup>3</sup> Notwithstanding federal law, North Carolina has enacted N.C. Gen. Stat. § 105-153.5(b)(5a) to allow a qualified individual to deduct from adjusted gross income (“AGI”) specific payments provided the payments are included in AGI.<sup>4</sup>

Specifically, for taxable years beginning on or after January 1, 2021, North Carolina allows a deduction for the following payments received during the taxable year from the United States government:

- a. Retirement pay for service in the Armed Forces of the United States to a retired member that meets either of the following:
  1. Served at least 20 years.
  2. Medically retired under [10 U.S.C. Chapter 61](#). This deduction does not apply to severance pay received by a member due to separation from the member's armed forces.

<sup>1</sup> See SB 105, s. 42.1A.(a); [S.L. 2021-180](#).

<sup>2</sup> See [IRC Publication 525 \(2021\)](#).

<sup>3</sup> See [IRC Publication 575 \(2021\)](#).

<sup>4</sup> See SB 105, s. 41.1A.(a); [S.L. 2021-180](#).

- b. Payments of a Plan defined in [10 U.S.C. § 1447](#) to a beneficiary of a retired member who is eligible to deduct retirement pay under N.C. Gen. Stat. § 105-153.5(b)(5a)(a).

In July 2022, North Carolina enacted new legislation that expands the eligibility of the military retirement deduction to certain members of the uniformed services (“Uniformed Services”).<sup>5</sup> For purposes of the new law, a qualifying member of the commissioned corps of the National Oceanic and Atmospheric Administration (“NOAA”) or the United States Public Health Service (“USPHS”) can deduct certain retirement pay when calculating North Carolina taxable income beginning tax year 2022.

FAQs regarding the new Uniformed Services provision of the statute are provided in [Topic D](#).

## **Frequently Asked Questions**

### **Topic A. Retirement Pay for Service in the Armed Forces**

**A1. What is the definition of “Armed Forces of the United States” for purposes of the deduction for retirement pay for service in the Armed Forces (the “Deduction”)?**

The term “Armed Forces of the United States” (“Armed Forces”) means the United States Army, United States Navy, United States Air Force, United States Marine Corps, United States Space Force, and the United States Coast Guard.<sup>6</sup>

**A2. Who is a retired member of the Armed Forces for purposes of the Deduction?**

A member or former member of the Armed Forces who is entitled, under statute, to retired, retirement, or retainer pay on account of service as a member.<sup>7</sup>

**A3. I am a retired member of the Armed Forces. I received retirement pay in 2021. Am I eligible for the Deduction?**

It depends. A retired member of the Armed Forces is eligible for the Deduction if the retired member meets either of the following:

- (1) Served at least 20 years in the Armed Forces; or
- (2) Was medically retired from the Armed Forces under [10 U.S.C. Chapter 61](#).<sup>8</sup>

For more information on medical retirement, see [Disability Retirement \(defense.gov\)](#).

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<sup>5</sup> See HB 103, s. 42.1.(a); [S.L. 2022-74](#). See also 10 U.S.C. § 101(a)(5).

<sup>6</sup> [10 U.S. Code § 101\(a\)\(4\)](#).

<sup>7</sup> [5 U.S. Code § 2108\(5\)](#).

<sup>8</sup> See SB 105, s. 42.1A.(a); [S.L. 2021-180](#).

**A4. I am a former member of the Armed Forces. I was separated from the military due to a medical issue. I received severance pay in 2021. Am I eligible for the Deduction?**

No. Severance pay received for separation from the Armed Forces is not eligible for the Deduction.<sup>9</sup>

**Note:** This provision only applies to disability severance pay that is included in the member's federal AGI. If a member's disability severance pay is not included in AGI, the payment will not be included in the member's North Carolina taxable income.

**A5. I am a retired civilian employee who worked for the Armed Forces. I received retirement pay in 2021. Do I qualify for the Deduction?**

No. Retirement pay received for work performed as a civilian employee does not qualify for the Deduction.

**A6. I am a retired military contractor who performed services for the Armed Forces. I received retirement pay related to these services from a third party in 2021. Am I eligible for the Deduction?**

No. Retirement pay received for work performed as a military contractor does not qualify for the Deduction.

**A7. I am a retired member of the Armed Forces. I am also a retired civilian employee of the United States government. I waived my military retirement pay and added my military service to my civilian service. I received retirement pay in 2021. Am I eligible for the Deduction?**

No. Retirement pay received for work performed as a civilian employee does not qualify for the Deduction.

**A8. My federal civil service retirement pay is based, in part, on my military service time. Am I eligible for the Deduction?**

No. Retirement pay received for work performed as a civilian employee does not qualify for the Deduction.

**A9. I am a retired member of the Armed Forces. I am also a retired civilian employee of the United States government. I did not waive my military retirement pay. I received retirement pay in 2021. Am I eligible for the Deduction?**

It depends. Retirement pay received by a retired member of the Armed Forces for military service of at least 20 years qualifies for the Deduction. Retirement pay received by a retired member of the Armed Forces who was medically retired under [10 U.S.C. Chapter 61](#) qualifies for the Deduction. Retirement pay received for work performed as a civilian employee does not qualify for the Deduction.

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<sup>9</sup> See SB 105, s. 42.5.(c,h); [S.L. 2021-180](#).

**A10. I am a retired member of the Armed Forces. How do I calculate my years of service for purposes of the Deduction?**

A retired member of the Armed Forces must use the provisions of [Title 10 of the United States Code](#) to determine length of service.

For more information, see [Retirement \(defense.gov\)](#).

**A11. I was medically retired from the Armed Forces under Chapter 61. Does the 20-year service requirement apply to me for purposes of the Deduction?**

No. The Deduction is available to a retired member who is medically retired under [Chapter 61](#) regardless of length of service.

**Note:** The Deduction does not apply to severance pay received by a former member of the Armed Forces due to separation from the Armed Forces.

For more information, see [Disability Retirement \(defense.gov\)](#).

**A12. I am a retired member of the Armed Forces. I received payments from the Thrift Savings Plan for tax year 2021.<sup>10</sup> Am I eligible for the Deduction?**

It depends. If the retired member served at least 20 years in the Armed Forces or was medically retired from the Armed Forces under [10 U.S.C. Chapter 61](#), then the payment received from the Thrift Savings Plan qualifies for the Deduction.

For more information, see [Thrift Savings Plan \(defense.gov\)](#).

**A13. Do retirement payments made to an individual other than the retired member of the Armed Forces qualify for the Deduction?**

No. North Carolina explicitly limits the Deduction to payments made to the retired member of the Armed Forces.

For example, the former spouse of the retired member of the Armed Forces may be entitled to receive a court-ordered payment from the retirement pay of the member. Because such payments are made to a person other than the retired member of the Armed Forces, the former spouse does not qualify for the Deduction.

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<sup>10</sup> [Thrift Savings Plan \(defense.gov\)](#).

## Topic B. Survivor Benefit Plan Payments

**B1. A beneficiary of a retired member may be eligible to deduct payments received from a “Plan defined in 10 U.S.C. § 1447” when calculating North Carolina taxable income. What is a “Plan defined in 10 U.S.C. § 1447?”**

A “Plan defined in [10 U.S.C. § 1447](#)” is the Survivor Benefit Plan (“SBP”). The SBP allows a retired member of the Armed Forces to purchase coverage that provides income to an eligible beneficiary.

For more information, see [Survivor Benefit Program Overview \(defense.gov\)](#).

**B2. Who is a “beneficiary of a retired member” for purposes of deducting an SBP payment?**

A beneficiary of a retired member is an eligible beneficiary as determined under the provisions of the SBP.

For more information, see [Survivor Benefit Program \(defense.gov\)](#).

**B3. I am a beneficiary of a retired member. I received an SBP payment in 2021. Am I eligible to deduct the SBP payment?**

It depends. If the retired member who purchased SBP coverage served at least 20 years in the Armed Forces or was medically retired from the Armed Forces under 10 U.S.C. Chapter 61, then the beneficiary of the retired member can deduct the SBP payment when calculating North Carolina taxable income.

**B4. I am a beneficiary of a retired member. I received a Thrift Savings Plan (“TSP”) payment in 2021.<sup>11</sup> Am I eligible to deduct the TSP payment?**

No. North Carolina explicitly limits the deduction to payments received from a Plan defined in 10 U.S.C. § 1447, which is the Survivor Benefit Program. See [FAQ B1](#).

## Topic C. Claiming the Deduction

**C1. I am a retired member of the Armed Forces. I am eligible for the Deduction. When can I deduct retirement pay?**

A retired member of the Armed Forces who is eligible for the Deduction (an “Eligible Armed Forces Retiree”) may deduct military retirement pay on a North Carolina individual income tax return (“NC Tax Return”) for tax years beginning 2021.

**Note:** If you are an Eligible Armed Forces Retiree who filed a NC Tax Return for tax year 2021 and included military retirement payments in your calculation of North Carolina taxable income, you should consider filing an amended NC Tax Return with the Department to deduct the

<sup>11</sup> [Thrift Savings Plan \(defense.gov\)](#).

payments. For more information on how to amend your 2021 NC Tax Return, [Form D-400](#), see the instructions for the return, [Form D-401](#), on the Department's website.

**C2. I am a beneficiary of a retired member of the Armed Forces. I am eligible to deduct an SBP payment. When can I deduct the SBP payment?**

A beneficiary of a retired member of the Armed Forces who is eligible to deduct an SBP payment (an "Eligible Beneficiary") may deduct the payment on a NC Tax Return beginning tax year 2021.

**Note:** If you are an Eligible Beneficiary who filed a NC Tax Return for tax year 2021, and you included an SBP payment in your calculation of North Carolina taxable income, you should consider filing an amended NC Tax Return with the Department to deduct the payment. For more information on how to amend your 2021 NC Tax Return, [Form D-400](#), see the instructions for the return, [Form-D401](#), on the Department's website.

**C3. I am an Eligible Armed Forces Retiree for tax year 2021. Where do I claim the Deduction?**

An Eligible Armed Forces Retiree can claim the Deduction on the [2021 Form D-400 Schedule S](#), Line 20.

**C4. I am an Eligible Beneficiary for tax year 2021. Where do I deduct the SBP payment?**

An Eligible Beneficiary can deduct an SBP payment on the [2021 Form D-400 Schedule S](#), Line 20.

**C5. I am an Eligible Armed Forces Retiree. I received military retirement pay in 2021. I am entitled to exclude my retirement pay under the "[Bailey Settlement](#)". Can I deduct my retirement pay twice, once on Line 19 (the Bailey Settlement line), and again on Line 20 (the Deduction line)?**

No. If you deduct your retirement pay on Line 19 of the 2021 Form D-400 Schedule S because the payment qualifies for the Bailey Settlement deduction, you may not deduct the same payment on Line 20 of the 2021 D-400 Schedule S.

## **Topic D. Retirement Pay for Service in the Uniformed Services**

**D1. What is the definition of "uniformed services of the United States" ("Uniformed Services") for purposes of the Deduction?<sup>12</sup>**

The term "Uniformed Services" means the Armed Forces,<sup>13</sup> the commissioned corps of the National Oceanic and Atmospheric Administration ("NOAA"), and the commissioned corps of the United States Public Health Service ("USPHS").<sup>14</sup>

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<sup>12</sup> See FAQ A1.

<sup>13</sup> *Id.*

<sup>14</sup> [10 U.S.C. § 101\(a\)\(5\)](#).

**D2. I retired from NOAA. I received retirement pay in 2022. Am I eligible for the Deduction?**

It depends. A retired member of NOAA is eligible for the Deduction (an “Eligible NOAA Retiree”) if the retired member meets either of the following:

- (1) Served at least 20 years in the NOAA; or
- (2) Was medically retired from the NOAA under [10 U.S.C. Chapter 61](#).<sup>15</sup>

**D3. I am an Eligible NOAA Retiree. I received retirement pay in 2022. Where do I claim the Deduction?**

An Eligible NOAA Retiree can claim the Deduction on the 2022 Form D-400 Schedule S.

**Note:** The 2022 Form D-400 Schedule S will be available on the [Department’s website](#) in January 2023.

**D4. I am an Eligible NOAA Retiree. I received retirement pay in 2021. I have already filed my 2021 NC Tax Return. Can I file an amended NC Tax Return and claim the Deduction?**

No. An Eligible NOAA Retiree is not eligible to claim the Deduction until tax year 2022.

**D5. I retired from USPS. I received retirement pay in 2022. Am I eligible for the Deduction?**

It depends. A retired member of USPS is eligible for the Deduction (an “Eligible USPS Retiree”) if the retired member meets either of the following:

- (1) Served at least 20 years in the USPS; or
- (2) Was medically retired from the USPS under [10 U.S.C. Chapter 61](#).

**D6. I am an Eligible USPS Retiree. I received retirement pay in 2022. Where do I claim the Deduction?**

An Eligible USPS Retiree can claim the Deduction on the 2022 Form D-400 Schedule S.

**Note:** The 2022 Form D-400 Schedule S will be available on the [Department’s website](#) in January 2023.

**D7. I am an Eligible USPS Retiree. I received retirement pay in 2021. I have already filed my 2021 NC Tax Return. Can I file an amended NC Tax Return for tax year 2021 and take the Deduction?**

No. An Eligible USPS Retiree is not eligible to claim the Deduction until tax year 2022.

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<sup>15</sup> See HB 103, s. 42.1(a); [S.L. 2022-74](#).

**D8. I am a beneficiary of a retired member of the NOAA or the USPHS. I am eligible for the Deduction. When and where do I claim the Deduction?**

A beneficiary of a retired member of either the NOAA or the USPHS who is eligible to deduct an SBP payment may take the Deduction on the 2022 Form D-400 Schedule S.

**Note:** The 2022 Form D-400 Schedule S will be available on the [Department's website](#) in January 2023.

### **Assistance**

If you have any questions about this notice, you may call the North Carolina Department of Revenue Customer Interaction Center at 1-877-252-3052 (8:00 am until 4:30 pm EST, Monday through Friday) or write the Department at PO Box 25000, Raleigh, NC 27640-0640.

*To the extent there is any change to a statute or regulation, or new case law subsequent to the date of this notice, the provisions in this notice may be superseded or voided. To the extent that any provisions in any other notice, directive, technical bulletin, or published guidance regarding the subject of this notice and issued prior to this notice conflict with this notice, the provisions contained in this important notice supersede the previous guidance.*