

TJAGSA Practice Notes

Faculty, The Judge Advocate General's School

Legal Assistance Items

The following notes advise legal assistance attorneys of current developments in the law and in legal assistance program policies. You may adopt them for use as locally published preventive law articles to alert soldiers and their families about legal problems and changes in the law. We welcome articles and notes for inclusion in this portion of *The Army Lawyer*; send submissions to The Judge Advocate General's School, ATTN: JAGS-ADA-LA, Charlottesville, Virginia 22903-1781.

Consumer Law Note

The Truth-in-Lending Act Can Help With Home Improvement Contracts

A recent case decided by the United States Court of Appeals for the Fifth Circuit highlights the utility of the Truth-in-Lending Act (TILA) protections when home improvements are financed with credit secured by a principal residence. In *Taylor v. Domestic Remodeling, Inc.*¹ [hereinafter *Taylor*], the Court held that a consumer had a three-year extended right to rescind a home improvement contract where notices required by the TILA were not properly given by the third party financing company and where the work began prior to the completion of the rescission period.²

The Court recounted the following facts in their decision:

In May, 1991, defendant Domestic Remodeling, Inc. ("Domestic") approached Mrs. Taylor about remodeling her home. Mrs. Taylor and her son Tom authorized Domestic to construct an addition onto the house and roof it. The total cash price of the agreed-upon remodeling was \$17,500.00. At the same time, the Taylors signed a loan application to obtain financing for the remodeling through Green Tree. On June 4, 1991, Green Tree

approved the loan, and on June 11, 1991, Mrs. Taylor signed a deed of trust granting a security interest in her home to Green Tree. That same day, she also signed a Notice of Right to Cancel which advised her that she had until midnight of June 14, 1991, or three business days from the date she received the Truth in Lending disclosures, or three days from the date she received the instant notice to cancel the transaction. Domestic and Green Tree did not give the Taylors the referenced Truth in Lending disclosures documenting particulars about the loan on June 11, 1991.

Whatever construction was done on the Taylor home began and ended on June 27, 1991. On that date, Mrs. Taylor signed a Completion Certificate and verified via telephone with Green Tree that the work was satisfactory. On that same day, Green Tree and Domestic finally gave Mrs. Taylor the Truth in Lending disclosures referenced in the Notice of Right to Cancel.³

The Taylors filed suit on 27 June 1994, and both parties consented to trial before a magistrate.⁴ The Taylors alleged that the work was in fact *not* completed nor satisfactory.⁵ They also asserted TILA violations and their TILA right to rescind, as well as state and common law claims.⁶ That court found for the Taylors on their claim that they had a right to rescind the contract under the TILA.⁷

The TILA provides a "cooling-off period" of three business days for any nonpurchase money credit transaction secured by the consumer's principal dwelling.⁸ However, the TILA does not begin the running of this three business day period until the consummation of the transaction or the delivery of the material disclosure forms, whichever occurs later.⁹ Failure to deliver the required forms or required information extends the rescission

1. 97 F.3d 96 (5th Cir. 1996).

2. *Id.* at 99.

3. *Id.* at 97 (emphasis added).

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.* at 98.

period for three years after the date of the consummation of the transaction.¹⁰

The regulations promulgated under the TILA require certain content in the notices and prohibit certain behavior during the rescission period. The notice of the right to rescind must disclose “clearly and conspicuously” the following:¹¹

1. The security interest in the dwelling;
2. How to exercise the right to rescind;
3. A form on which to exercise the rescission right;
4. The effects of rescission; and
5. The date the rescission period expires.

Further, these regulations provide that “no money shall be disbursed other than in escrow, no services shall be performed and no materials delivered until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded.”¹²

The court in *Taylor* noted that, in its precedent, it had identified a two-fold intent behind these disclosure requirements.¹³ This intent was to provide for a right of rescission first, “upon the creditor's failure to disclose material information about the transaction itself,”¹⁴ and second, “upon the creditor's failure to

disclose the required information regarding the consumer's right to rescind.”¹⁵

In *Taylor*, the Court found that the second intent of the disclosure provisions was violated by a combination of two errors. First, the disclosed date of the expired rescission period was incorrect because the rescission period did not actually begin to run until the proper notices were delivered on 27 June 1991.¹⁶ Second, by the time the Taylors received the notice, “the construction was as complete as it would ever be, and they were facing a *fait accompli*.”¹⁷ The Court noted “that while the TILA does not demand unyielding compliance with detail, full and honest disclosure is exacted.”¹⁸ The Court held that this full and honest disclosure had not been made because the two errors worked together to produce “a material failure to disclose to the Taylors their right to rescind.”¹⁹ Because of this improper disclosure, the Taylors had three years to rescind.²⁰ The Court went on to hold that the filing of the complaint in the case satisfied the requirement of notice of rescission.²¹

The case raises some important points for the legal assistance practitioner to remember. First, the TILA provides important remedies for home improvement situations. These transactions often involve credit that is secured by the home being improved. If the home is the principal dwelling for the

8. 15 U.S.C.A. § 1635 (a) (West 1996). The regulation implementing this statute provides:

In a credit transaction in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind the transaction To exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication. Notice is considered given when mailed, when filed for telegraphic transmission or, if sent by other means, when delivered to the creditor's designated place of business. The consumer may exercise the right to rescind until midnight of the third business day following consummation, delivery of the notice [of the rescission right], or delivery of all material disclosures, whichever occurs last. If the required notice or material disclosures are not delivered, the right to rescind shall expire 3 years after consummation, upon transfer of all of the consumer's interest in the property, upon sale of the property, whichever occurs first.

12 C.F.R. § 226.23 (a) (1997) (footnotes omitted). The rule also exempts certain loans from this provision. These are, essentially, purchase-money loans secured by the property. *Id.* § 226.23(f).

9. 12 C.F.R. § 226.23(a)(3) (1997). *See also supra* note 8.

10. 12 C.F.R. § 226.23(a)(3) (1997).

11. *Id.* § 226.23(b).

12. *Id.* § 226.23(c).

13. *Taylor v. Domestic Remodeling, Inc.*, 97 F.3d 96, 99 (5th Cir. 1996) *citing* *Williamson v. Lafferty*, 698 F.2d 767, 768 (5th Cir. 1983).

14. *Id.*

15. *Id.*

16. *Id.* at 99.

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.* at 99-100.

consumer, he may have a powerful remedy in the TILA rescission right.²² Second, relatively minor disclosure errors will still provide an extended right to rescind under the contract.²³ Even if the client is “late” approaching you, the situation may fit into the three-year rescission period rather than the three-day period. Third, the rescission process usually will protect the consumer against the contractor *and* the third party creditor. While the consumer normally has to tender any money or property delivered (or the reasonable value of property if return is impracticable) back to the creditor, the TILA still provides some relief on the contract by eliminating credit charges.²⁴ In cases, as here, where the contractor has performed prematurely during the rescission period, full protection should be provided against any liability for the transaction because the consumer can supposedly cancel the transaction within the rescission period “without cost.”²⁵ Since allowing the contractors to benefit from early performance would effectively foreclose this right, courts most likely will place the risk of early performance on the contractor.²⁶ Finally, it is important in your preventive law program to place the rescission right in the home improvement context and inform consumers that this rescission period exists for at least some of these transactions. Additionally, they should be advised to allow no work to be done before the rescission period expires. This assures them of their opportunity to consider the situation fully and without cost before they proceed with an obligation that will burden their principal dwelling. Major Lescault.

Family Law Note

Proper Jurisdiction to Divide Military Disposable Retired Pay Is Reinforced by Colorado Court

The Uniformed Services Former Spouses Protection Act (USFSPA)²⁷ allows states to treat military retired pay as marital property and divide disposable military retired pay during a divorce. This does not create a federal right to a portion of the military retired pay; the division is controlled by state law. The USFSPA does, however, impose on the states a preliminary jurisdictional requirement that must be met before the state applies state law to the division of military retirement pay. A state court cannot divide military retired pay as marital property unless the court has jurisdiction over the military member or retiree under one of three bases: (1) domicile, (2) residence in the state, other than because of military assignment, or (3) consent.²⁸ This is an area several practitioners and courts overlook. Most courts consider this section of the USFSPA as a limitation on the subject matter jurisdiction over military retired pay.²⁹ It is therefore a threshold question that must be addressed before any division of the military retired pay. It is important for practitioners to remember that jurisdiction over dissolution of the marriage, awards of child support, and child custody does not necessarily mean a court has jurisdiction over the division of military retirement pay as property.

In the case of *In re the Marriage of Carol Jean Akins and James Akins, Jr.*,³⁰ James Akins, the military member, challenged the Colorado trial court’s jurisdiction to divide his military retirement pay. Mrs. Akins and the children resided in Colorado Springs for twelve years while he was on active duty. He resided in Colorado only four of those years, between 1982 and 1986. He continued to visit his family in Colorado periodically until divorce actions were initiated in January 1994. He maintained Colorado as his state of residence for tax purposes until early 1994 when he switched it to North Carolina. Colo-

22. The rescission right is extremely powerful because of its effect. Rescission *voids* the security interest and eliminates any obligation the consumer has to pay finance or other credit charges (such as closing costs). These effects occur automatically at rescission. 15 U.S.C.A. § 1635 (West 1996); 12 C.F.R. §§ 226.15, 226.23 (1997).

23. Note that some errors will be too small and considered merely technical in nature. For example, the Third Circuit Court of Appeals found that the mere delivery of the loan proceeds during the rescission period did *not* violate the prohibition of performance during that period. *Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 896 (3d Cir. 1990). Similarly, the Arkansas Supreme Court found a mere technical error when the credit company misstated the end date of the rescission period by one day and there were no other errors. *Bank of Evening Shade v. Lindsey*, 644 S.W.2d 920 (1983).

24. See NATIONAL CONSUMER LAW CENTER, TRUTH IN LENDING §§ 6.10.5, 6.10.6 (3d ed. 1995 & Supp. 1996). Note that home improvement contractors often try to avoid this result by establishing a “cash” contract with the consumer and then having the consumer get a “direct loan” from the creditor. Courts generally see through this scheme, sometimes referred to as the “two-contract dodge,” and provide the TILA protections to the consumer against both parties. *Id.* § 6.8.4.2.2. This scheme is usually part of a course of action known as “spiking” where the contractor begins work before the rescission period ends in order to influence the consumer not to rescind. Courts tend to view this practice as particularly egregious because it tends to effectively foreclose the consumer’s right to rescind. Under the rules, the consumer would ordinarily have to tender the property back or its reasonable value. For attachments to a home, the consumer may be stuck paying for work (often substandard) even though he is supposed to be able to rescind “without cost.” Courts that recognize the “spiking” scheme should not require the consumer to pay anything—even for the items installed. *Id.* §§ 6.8.4.2., 6.8.4.3

25. See Model Disclosures G-6 - G-9 and H-8 - H-9, 12 C.F.R., Part 226, Appendices G & H.

26. See the citations and discussion of “spiking,” *supra* note 24.

27. 10 U.S.C.A. § 1408 (West 1996).

28. *Id.* § 1408(c)(4).

29. *In re the Marriage of Carol Jean Akins and James Akins, Jr.*, 932 P.2d 863 (Colo. App. 1997).

30. *Id.*

rado's trial court relied on long arm jurisdiction principles of minimum contacts to determine that it had personal jurisdiction to adjudicate the divorce, custody, support, and property division. Mr. Akins made a special appearance to contest jurisdiction over his military retirement pay. He therefore did not consent to jurisdiction. Because he no longer resided in Colorado, the only basis for jurisdiction to divide his military pension was the fact that he was domiciled there. The appellate court remanded the case for findings by the trial court as to whether Mr. Akins' domicile was Colorado or North Carolina. The court makes clear that the controlling question is where was Mr. Akins' domicile at the time of the commencement of the proceedings. A court's jurisdiction cannot be based upon the military member's past residence or past domicile in the state.³¹

All states now recognize a right to divide military retired pay as marital property; therefore, it is essential that the attorney consider the jurisdictional restrictions imposed on the states by the USFSPA when counseling clients on the division of military retired pay. Major Fenton.

Tax Law Notes

Assisting Survivors When Spouse Died in a Combat Zone

A member of the United States Armed Forces who dies in a combat zone³² is entitled to forgiveness of all income taxes due in the year of death.³³ Thus, the survivor will be entitled to a refund of any income taxes that were from that servicemember's income during the tax year in which the servicemember died. In addition, a service member who dies in a combat zone or hazardous duty area is entitled to forgiveness of taxes for previous years in which the statute of limitations is still open.³⁴ Thus, the survivor is entitled to a refund of any taxes paid by the decedent in prior years for which the individual, if alive, could file an amended return. As a general rule, an individual can only file an amended return for three years.³⁵ Thus, if an individual were to die in a combat zone or hazardous duty area

in 1996, taxes owed or paid by that individual for 1993, 1994, 1995, and 1996 would be forgiven, provided that the survivor files the appropriate returns prior to 15 April 1997. If the survivor fails to file an amended return by 15 April 1997, he could still receive a refund for tax paid by the decedent in 1994, 1995, and 1996, provided that the survivor files the appropriate returns prior to 15 April 1998.

In order to claim the refund, the surviving spouse needs to file a Form 1040, or a 1040X if it is an amended return, to the Internal Revenue Service Center (ATTN: Stop 2), P.O. Box 267, Covington, Kentucky 41019.³⁶ The phrase "KITA-see attached" should be entered on the line where total tax would normally be entered. In addition, Form 1310 and a certification from the Department of Defense or the Department of State that the death was the result of terrorist or military action outside the United States must be attached.³⁷ Finally, if the return in question is for a joint return, an apportionment must be done between the decedent's income and the surviving spouse's income.³⁸ Major Henderson.

Tax Consequences of the Department of Defense Educational Loan Repayment Program

Service members who enlist and have some of their student loans repaid by the Department of Defense must report the repayment by the Department of Defense as income.³⁹ In *Vazquez v. Commissioner*, the taxpayer incurred student loans prior to entering active duty in the Army. In 1992, the Army paid \$2,985.86 toward his outstanding student loan. This payment was made pursuant to the Department of Defense Educational Loan Repayment Program.⁴⁰ The Internal Revenue Service determined that the \$2,985.86 was gross income to the service member and determined a deficiency.

The service member filed a petition in tax court to dispute the deficiency. The tax court noted that gross income specifically includes compensation for services and income from discharge of indebtedness.⁴¹ The service member, who was stationed at Fitzsimons Army Medical Center, argued that he

31. *Id.* at 4.

32. See Tax Benefits for Servicemen in Bosnia and Herzegovina, Pub. L. No. 104-117, 109 Stat. 827 (1996), which defines combat zone to include a qualified hazardous area and defines Bosnia, Herzegovina, Macedonia, and Croatia as qualified hazardous duty areas.

33. I.R.C. § 692(a)(1) (RIA 1996).

34. *Id.* § 692(a)(2).

35. *Id.* § 6511(a).

36. Rev. Proc. 85-35, 1985-2 C.B. 433.

37. *Id.*

38. See Treas. Reg. § 1.692.1(b) and Rev. Rul. 85-103, 1985-2 C.B. 176.

39. *Vazquez v. Commissioner*, 73 T.C.M. (CCH) 2016 (1997).

40. 10 U.S.C. § 2171 (1988).

was being treated unfairly because military personnel in other professions, such as nurses and doctors, receive tax exempt educational subsidies. The tax court stated that even assuming the taxpayer's characterization of the law was correct, the taxpayer's remedy was with Congress.

Legal assistance attorneys who assist enlisted soldiers should determine whether any of their clients participated in this program. If any clients did participate, they need to report the repayment as income on their tax return. The repayment may or may not be reported on their W-2 Form. In fact, in *Vazquez*, the repayment was not reported on that service member's W-2 Form. Major Henderson.

Garnishment of an IRA

Legal assistance attorneys dealing with garnishment actions for clients who have Individual Retirement Accounts need to be especially diligent in ensuring that the IRA itself is not garnished. The tax court recently ruled that a garnishment from an IRA is a premature withdrawal.⁴² Thus, the withdrawal must be reported as income in the year of "withdrawal."⁴³ Further, since the withdrawal will not meet any of the exceptions to the imposition of the additional 10% tax on premature withdrawals,⁴⁴ the taxpayer will also have to pay the 10% penalty for early withdrawal.⁴⁵

In *Vorwald v. Commissioner*,⁴⁶ the petitioner had fallen behind in child support payments and his ex-spouse obtained and executed a garnishment order against his IRA. The IRS determined a deficiency against the petitioner for the withdrawal from the IRA. The IRS also assessed the additional 10% tax for early withdrawal from the IRA. The petitioner filed a petition with the tax court, but the tax court sided with the IRS. Major Henderson.

Administrative and Civil Law Notes

Standards of Conduct: Change to the Gift Rules

The Deputy Secretary of Defense changed Department of Defense (DOD) Directive 5500.7-R which concerns gift rules.⁴⁷ The change allows employees (superiors) to accept gifts from a group of employees (which includes a subordinate in the group) when the value of the gift exceeds \$300 in value. This change only applies to gifts to superiors on special, infrequent occasions that terminate the superior-subordinate relationship. The change became effective on 3 January 1997. The following new subsection appears after section 2-203(a):⁴⁸

(3) Notwithstanding the \$300 limitation of section 2-203 of this regulation, gifts from a group that includes a subordinate may exceed \$300 if:

- (a) They are appropriate for the occasion,
- (b) They are given on a special, infrequent occasion that terminates the subordinate-official superior relationship, such as retirement, resignation, or transfer, and,
- (c) They are uniquely linked to the departing employee's position or tour of duty, and commemorate the same.

This significant change in the gift rules will be particularly challenging for Ethics Counselors. When opining on the legality of retirement, resignation, or transfer gifts, the issue is no longer the definite \$300 limit. Now Ethics Counselors have the formidable task of determining whether the gift is "appropriate to the occasion." Department of the Army, Office of The Judge Advocate General, Standards of Conduct Office (SOCO), advises that "appropriate to the occasion" should normally not exceed \$300.⁴⁹ In other words \$300 is a strong indication of what is "appropriate to the occasion." *The Army Lawyer's* May, 1996 article, *An Overview and Practitioner's Guide to Gifts*, provides practitioners with a resource for analyzing gift issues. Ethics Counselors should note that the article was published prior to this change. Major Castlen.

41. *Id.*; See also I.R.C. §§ 61(a)(1), 61(a)(12) (RIA 1996).

42. *Vorwald v. Commissioner*, 73 T.C.M. (CCH) 1697 (1997).

43. I.R.C. § 408(d) (RIA 1996).

44. *Id.* § 72(t)(2).

45. *Id.* § 72(t)(1).

46. 73 T.C.M. (CCH) 1697 (1997).

47. JOINT ETHICS REG. § 2-203(a) (Aug. 1993).

48. DEP'T OF DEFENSE, OFFICE OF GEN. COUNSEL, SOCO ADVISORY OPINION 97-02 (Jan. 8, 1997).

49. Telephone Interview with Colonel Ruppert, Department of the Army, Office of The Judge Advocate General, Standards of Conduct Office (Mar. 25, 1997).

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In the case of *In re the Marriage of Carol Jean Akins and James Akins, Jr.*,⁷⁹ James Akins, the military member, challenged the Colorado trial court’s jurisdiction to divide his military retirement pay. Mrs. Akins and the children resided in Colorado Springs for twelve years while he was on active duty. He resided in Colorado only four of those years, between 1982 and 1986. He continued to visit his family in Colorado periodically until divorce actions were initiated in January 1994. He maintained Colorado as his state of residence for tax purposes until early 1994 when he switched it to North Carolina. Colo-

71. The rescission right is extremely powerful because of its effect. Rescission *voids* the security interest and eliminates any obligation the consumer has to pay finance or other credit charges (such as closing costs). These effects occur automatically at rescission. 15 U.S.C.A. § 1635 (West 1996); 12 C.F.R. §§ 226.15, 226.23 (1997).

72. Note that some errors will be too small and considered merely technical in nature. For example, the Third Circuit Court of Appeals found that the mere delivery of the loan proceeds during the rescission period did *not* violate the prohibition of performance during that period. *Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 896 (3d Cir. 1990). Similarly, the Arkansas Supreme Court found a mere technical error when the credit company misstated the end date of the rescission period by one day and there were no other errors. *Bank of Evening Shade v. Lindsey*, 644 S.W.2d 920 (1983).

73. See NATIONAL CONSUMER LAW CENTER, *TRUTH IN LENDING* §§ 6.10.5, 6.10.6 (3d ed. 1995 & Supp. 1996). Note that home improvement contractors often try to avoid this result by establishing a “cash” contract with the consumer and then having the consumer get a “direct loan” from the creditor. Courts generally see through this scheme, sometimes referred to as the “two-contract dodge,” and provide the TILA protections to the consumer against both parties. *Id.* § 6.8.4.2.2. This scheme is usually part of a course of action known as “spiking” where the contractor begins work before the rescission period ends in order to influence the consumer not to rescind. Courts tend to view this practice as particularly egregious because it tends to effectively foreclose the consumer’s right to rescind. Under the rules, the consumer would ordinarily have to tender the property back or its reasonable value. For attachments to a home, the consumer may be stuck paying for work (often substandard) even though he is supposed to be able to rescind “without cost.” Courts that recognize the “spiking” scheme should not require the consumer to pay anything—even for the items installed. *Id.* §§ 6.8.4.2., 6.8.4.3

74. See Model Disclosures G-6 - G-9 and H-8 - H-9, 12 C.F.R., Part 226, Appendices G & H.

75. See the citations and discussion of “spiking,” *supra* note 24.

76. 10 U.S.C.A. § 1408 (West 1996).

77. *Id.* § 1408(c)(4).

78. *In re the Marriage of Carol Jean Akins and James Akins, Jr.*, 932 P.2d 863 (Colo. App. 1997).

79. *Id.*

rado's trial court relied on long arm jurisdiction principles of minimum contacts to determine that it had personal jurisdiction to adjudicate the divorce, custody, support, and property division. Mr. Akins made a special appearance to contest jurisdiction over his military retirement pay. He therefore did not consent to jurisdiction. Because he no longer resided in Colorado, the only basis for jurisdiction to divide his military pension was the fact that he was domiciled there. The appellate court remanded the case for findings by the trial court as to whether Mr. Akins' domicile was Colorado or North Carolina. The court makes clear that the controlling question is where was Mr. Akins' domicile at the time of the commencement of the proceedings. A court's jurisdiction cannot be based upon the military member's past residence or past domicile in the state.⁸⁰

All states now recognize a right to divide military retired pay as marital property; therefore, it is essential that the attorney consider the jurisdictional restrictions imposed on the states by the USFSPA when counseling clients on the division of military retired pay. Major Fenton.

Tax Law Notes

Assisting Survivors When Spouse Died in a Combat Zone

A member of the United States Armed Forces who dies in a combat zone⁸¹ is entitled to forgiveness of all income taxes due in the year of death.⁸² Thus, the survivor will be entitled to a refund of any income taxes that were from that servicemember's income during the tax year in which the servicemember died. In addition, a service member who dies in a combat zone or hazardous duty area is entitled to forgiveness of taxes for previous years in which the statute of limitations is still open.⁸³ Thus, the survivor is entitled to a refund of any taxes paid by the decedent in prior years for which the individual, if alive, could file an amended return. As a general rule, an individual can only file an amended return for three years.⁸⁴ Thus, if an individual were to die in a combat zone or hazardous duty area

in 1996, taxes owed or paid by that individual for 1993, 1994, 1995, and 1996 would be forgiven, provided that the survivor files the appropriate returns prior to 15 April 1997. If the survivor fails to file an amended return by 15 April 1997, he could still receive a refund for tax paid by the decedent in 1994, 1995, and 1996, provided that the survivor files the appropriate returns prior to 15 April 1998.

In order to claim the refund, the surviving spouse needs to file a Form 1040, or a 1040X if it is an amended return, to the Internal Revenue Service Center (ATTN: Stop 2), P.O. Box 267, Covington, Kentucky 41019.⁸⁵ The phrase "KITA-see attached" should be entered on the line where total tax would normally be entered. In addition, Form 1310 and a certification from the Department of Defense or the Department of State that the death was the result of terrorist or military action outside the United States must be attached.⁸⁶ Finally, if the return in question is for a joint return, an apportionment must be done between the decedent's income and the surviving spouse's income.⁸⁷ Major Henderson.

Tax Consequences of the Department of Defense Educational Loan Repayment Program

Service members who enlist and have some of their student loans repaid by the Department of Defense must report the repayment by the Department of Defense as income.⁸⁸ In *Vazquez v. Commissioner*, the taxpayer incurred student loans prior to entering active duty in the Army. In 1992, the Army paid \$2,985.86 toward his outstanding student loan. This payment was made pursuant to the Department of Defense Educational Loan Repayment Program.⁸⁹ The Internal Revenue Service determined that the \$2,985.86 was gross income to the service member and determined a deficiency.

The service member filed a petition in tax court to dispute the deficiency. The tax court noted that gross income specifically includes compensation for services and income from discharge of indebtedness.⁹⁰ The service member, who was stationed at Fitzsimons Army Medical Center, argued that he

80. *Id.* at 4.

81. See Tax Benefits for Servicemen in Bosnia and Herzegovina, Pub. L. No. 104-117, 109 Stat. 827 (1996), which defines combat zone to include a qualified hazardous area and defines Bosnia, Herzegovina, Macedonia, and Croatia as qualified hazardous duty areas.

82. I.R.C. § 692(a)(1) (RIA 1996).

83. *Id.* § 692(a)(2).

84. *Id.* § 6511(a).

85. Rev. Proc. 85-35, 1985-2 C.B. 433.

86. *Id.*

87. See Treas. Reg. § 1.692.1(b) and Rev. Rul. 85-103, 1985-2 C.B. 176.

88. *Vazquez v. Commissioner*, 73 T.C.M. (CCH) 2016 (1997).

89. 10 U.S.C. § 2171 (1988).

was being treated unfairly because military personnel in other professions, such as nurses and doctors, receive tax exempt educational subsidies. The tax court stated that even assuming the taxpayer's characterization of the law was correct, the taxpayer's remedy was with Congress.

Legal assistance attorneys who assist enlisted soldiers should determine whether any of their clients participated in this program. If any clients did participate, they need to report the repayment as income on their tax return. The repayment may or may not be reported on their W-2 Form. In fact, in *Vazquez*, the repayment was not reported on that service member's W-2 Form. Major Henderson.

Garnishment of an IRA

Legal assistance attorneys dealing with garnishment actions for clients who have Individual Retirement Accounts need to be especially diligent in ensuring that the IRA itself is not garnished. The tax court recently ruled that a garnishment from an IRA is a premature withdrawal.⁹¹ Thus, the withdrawal must be reported as income in the year of "withdrawal."⁹² Further, since the withdrawal will not meet any of the exceptions to the imposition of the additional 10% tax on premature withdrawals,⁹³ the taxpayer will also have to pay the 10% penalty for early withdrawal.⁹⁴

In *Vorwald v. Commissioner*,⁹⁵ the petitioner had fallen behind in child support payments and his ex-spouse obtained and executed a garnishment order against his IRA. The IRS determined a deficiency against the petitioner for the withdrawal from the IRA. The IRS also assessed the additional 10% tax for early withdrawal from the IRA. The petitioner filed a petition with the tax court, but the tax court sided with the IRS. Major Henderson.

Administrative and Civil Law Notes

Standards of Conduct: Change to the Gift Rules

The Deputy Secretary of Defense changed Department of Defense (DOD) Directive 5500.7-R which concerns gift rules.⁹⁶ The change allows employees (superiors) to accept gifts from a group of employees (which includes a subordinate in the group) when the value of the gift exceeds \$300 in value. This change only applies to gifts to superiors on special, infrequent occasions that terminate the superior-subordinate relationship. The change became effective on 3 January 1997. The following new subsection appears after section 2-203(a):⁹⁷

(3) Notwithstanding the \$300 limitation of section 2-203 of this regulation, gifts from a group that includes a subordinate may exceed \$300 if:

- (a) They are appropriate for the occasion,
- (b) They are given on a special, infrequent occasion that terminates the subordinate-official superior relationship, such as retirement, resignation, or transfer, and,
- (c) They are uniquely linked to the departing employee's position or tour of duty, and commemorate the same.

This significant change in the gift rules will be particularly challenging for Ethics Counselors. When opining on the legality of retirement, resignation, or transfer gifts, the issue is no longer the definite \$300 limit. Now Ethics Counselors have the formidable task of determining whether the gift is "appropriate to the occasion." Department of the Army, Office of The Judge Advocate General, Standards of Conduct Office (SOCO), advises that "appropriate to the occasion" should normally not exceed \$300.⁹⁸ In other words \$300 is a strong indication of what is "appropriate to the occasion." *The Army Lawyer's* May, 1996 article, *An Overview and Practitioner's Guide to Gifts*, provides practitioners with a resource for analyzing gift issues. Ethics Counselors should note that the article was published prior to this change. Major Castlen.

90. *Id.*; See also I.R.C. §§ 61(a)(1), 61(a)(12) (RIA 1996).

91. *Vorwald v. Commissioner*, 73 T.C.M. (CCH) 1697 (1997).

92. I.R.C. § 408(d) (RIA 1996).

93. *Id.* § 72(t)(2).

94. *Id.* § 72(t)(1).

95. 73 T.C.M. (CCH) 1697 (1997).

96. JOINT ETHICS REG. § 2-203(a) (Aug. 1993).

97. DEP'T OF DEFENSE, OFFICE OF GEN. COUNSEL, SOCO ADVISORY OPINION 97-02 (Jan. 8, 1997).

98. Telephone Interview with Colonel Ruppert, Department of the Army, Office of The Judge Advocate General, Standards of Conduct Office (Mar. 25, 1997).