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Income paid to Blackwater operative for Iraq service wasn't excludable combat pay (02/10/2011)

Federal Taxes Weekly Alert,

Income paid to Blackwater operative for Iraq service wasn't excludable combat pay

Holmes, TC Memo 2011-26

The Tax Court has held that income a taxpayer received from Blackwater Security Consulting (Blackwater) for dangerous security work performed in Iraq wasn't excludable from gross income under the Code Sec. 112 exclusion for compensation paid to the U.S. military serving in a combat zone.

Background. Under Code Sec. 112(a) , gross income does not include compensation received for active service as a member below the grade of commissioned officer in the U.S. Armed Forces for any month during any part of which the service member served in a combat zone. Reg. § 1.112-1(a)(4) states that only compensation paid by the U.S. Armed Forces to members of the Armed Forces can be excluded under Code Sec. 112 , except for compensation paid by an agency or instrumentality of the U.S. or by an international organization to a member of the Armed Forces whose military active duty status continues during the member's assignment to the agency or instrumentality or organization on official detail.

Under Code Sec. 7701(a)(15) , the U.S. Armed Forces include all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, and the Coast Guard. The members of these forces include commissioned officers and personnel below the grade of commissioned officers in such forces.

Facts. For the year at issue (2005), Nathaniel Holmes was engaged by Blackwater to perform dangerous security services in Iraq. For his work in Iraq related to military operations, he received compensation of \$98,400. For 2005, Iraq was identified as a combat zone under Executive Order 12744, 56 Fed. Reg. 2663 (Jan. 23, 1991).

Court's conclusion. The Tax Court concluded that Holmes wasn't entitled to the Code Sec. 112 exclusion. He did not serve in the U.S. Armed Forces, but rather was a private citizen who was hired by and paid by a private company, Blackwater. His compensation from Blackwater was not excludable from income because it was not compensation paid by the U.S. Armed Forces to a member of the Armed Forces.

The Court rejected the taxpayer's contention that because he was performing services similar to those performed by the U.S. military and because he performed those services in a combat zone, he should be allowed to exclude the pay he received from Blackwater. The Court reasoned that at no time in 2005 was he actually a member of the U.S. Armed Forces. Further, under Reg. § 1.112-1(a)(4) , compensation paid by other employers (whether private enterprises or governmental entities) to members of the Armed Forces cannot be excluded under Code Sec. 112 .

The Tax Court's holding was consistent with its previous decisions. In *Land* (1974), 61 TC 675 , the Court held that a pilot employed by a private airline flying civilian aircraft under contract with the Department of Defense in support of the U.S. military in a combat zone during the Vietnam War wasn't a member of the Armed Forces and so wasn't entitled to the Code Sec. 112 exclusion. In *Hildebran*, TC Memo 2004-42 , the Court held that a taxpayer employed as a merchant marine by a private company and assigned to work aboard a U.S. naval ship which operated in a combat zone wasn't a member of the Armed Forces and so wasn't entitled to the Code Sec. 112 exclusion.

References: For the combat zone exclusion, see FTC 2d/FIN ¶ H-3106 et seq.; United States Tax Reporter ¶ 1124 ; TaxDesk ¶ 138,005 et seq.; TG ¶ 7104 .

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