United States General Accounting Office

GAO

Report to Congressional Committees

April 1995

VETERANS COMPENSATION

Offset of DOD Separation Pay and VA Disability Compensation

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GAO/NSIAD-95-123

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United States
General Accounting Office
Washington, D.C. 20548

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B-260044

April 3, 1995

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United States Senate

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The Honorable Ronald V. Dellums
Ranking Minority Member
Committee on National Security
House of Representatives

The Honorable Bob Stump
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The Honorable G.V. (Sonny) Montgomery
Ranking Minority Member
Committee on Veterans Affairs
House of Representatives

As required by the National Defense Authorization Act for Fiscal Year 1995, we examined issues related to the legally required offset of certain types of Department of Defense (DOD) separation pay. In these offsets, money is withheld from veterans who also qualify for monthly disability pay from the Department of Veterans Affairs (VA).

In this report we (1) explain the purpose of the separation pay programs, (2) explain the justification for offsetting pay, (3) estimate the cost to the federal government of repealing certain offsets, and (4) determine whether these offsets have discouraged personnel from separating voluntarily. At your request, we also examined how the federal government taxes

separation and disability pay but, as agreed with your offices, we will address that issue in a separate letter when the work is complete.

Background

In 1991 (P.L. 102-190, National Defense Authorization Act for Fiscal Years 1992 and 1993), Congress authorized special separation pay from DOD to personnel who separate voluntarily by September 30, 1999, but are not eligible to retire. To shape the force structure and retain personnel in hard-to-fill military occupations, DOD is authorized to target special separation pay offers to service members in selected military occupations. Service members who voluntarily separate may choose from two voluntary separation pay plans—(1) a lump sum payment, known as a special separation benefit (SSB) or (2) an annual annuity, known as a voluntary separation incentive (VSI).[1]

DOD may involuntarily separate service members and provide them either full or reduced lump sum separation pay if they received an honorable or a general discharge, under authority granted by Congress in 1980 (P.L. 96-513, Defense Officer Personnel Management Act).[2] DOD may reduce this pay if the separating service member is deemed not fully qualified for retention and is denied reenlistment or continuation in the military service under the following conditions, if (1) the member's service obligation has expired, (2) DOD has changed the member's service obligation, (3) the separation is for the convenience of the government, (4) the service member has engaged in homosexual conduct, (5) the service member has failed drug or alcohol abuse rehabilitation, (6) the service member is unable to maintain a required security clearance, or (7) the service member has failed to meet weight control standards.

VA issues monthly disability compensation to veterans determined to have a service-connected disability. The size of the payments is based on the degree of the veteran's disability. The payments compensate for an assumed reduced earning power in the civilian economy. Payments are made for as long as the service-connected disability persists. The laws that authorize separation payments also prohibit veterans from receiving both

[1]The SSB is calculated as 15 percent of the service member's final monthly basic pay multiplied by 12 and again by the member's years of service. The VSI is calculated as 2.5 percent of the member's final monthly basic pay multiplied by 12 and again by the service member's years of service. The VSI is paid annually for twice the number of years of service.

[2]Involuntary separation pay is calculated as 10 percent of the service member's final monthly basic pay multiplied by 12 and again by the member's years of service. See appendix I for a comparison of involuntary and voluntary separation pay amounts at selected pay grades.

DOD separation pay and VA disability compensation if both forms of compensation stem from a single period of service.

Results in Brief

DOD uses separation pay as an incentive to people to serve in the military despite the risk of involuntary separation. Congress authorized special separation pay to minimize the use of involuntary separations in the ongoing force drawdown. Pay offsets prevent service members from receiving dual compensation for a single period of service.

Repealing offsets for separation and disability pay would cost the federal government an estimated $435 million (in 1994 dollars) for those service members who separated from fiscal years 1995-99.[3] A repeal would cost about $799 million if it was made retroactive to fiscal year 1992, when the special separation pay program began.[4]

Separation and disability pay offsets have not significantly undermined the voluntary separation incentive. According to DOD, the bulk of the drawdown since fiscal year 1992 has been accomplished through voluntary separations. DOD requires the services to inform separating service members of the existence of the offset.

Separation Pay

DOD helps separating service members to maintain a level of income after discharge by paying separation pay. Separation pay for involuntary separation provides an incentive to pursue a military career with the knowledge that DOD will provide compensation if, for example, the service member twice fails promotion to the next higher grade, under the up or out promotion system.

Special separation pay helps DOD to meet downsizing goals while minimizing the use of involuntary separation. The pay for voluntary separation is higher than for involuntary separation. Thus, service members have an incentive to separate voluntarily.

[3]This estimate does not take military pay raises into account that Congress may grant from fiscal years 1995-99.

[4]These estimates do not include the administrative costs of reimbursing those who have already separated.

Justification for and Workings of Separation and Disability Pay Offsets

The offsets prevent veterans from receiving dual compensation for a single period of service.[5] VA withholds the full amount of monthly disability pay from veterans who received an SSB or involuntary separation lump sum payment. DOD withholds an amount of the annual VSI payment equal to the disability compensation paid by VA during the year.

The outstanding repayment balance is reduced each month by the amount of the withheld monthly disability compensation or the withheld annual VSI until the full separation amount is recouped. At that point, veterans, who received a lump-sum separation payment, begin to actually receive monthly disability compensation.

In 1891, Congress first prohibited the concurrent receipt of dual forms of compensation in the military, banning the payment of pensions (as disability compensation was then known) to active duty or retired personnel. The current prohibition was enacted in 1958 and has remained relatively unchanged. The acts authorizing voluntary and involuntary separation pay also prohibit the concurrent receipt of VA disability compensation.

Cost of Repealing Separation and Disability Pay Offsets

We project that DOD will separate about 85,400 service members eligible for separation pay from fiscal years 1995-99, and about 13,700 (16 percent) of those will also qualify for disability compensation from VA.[6] Repealing the offsets would cost the federal government an estimated $435 million to compensate service members who separated from fiscal years 1995-99 and qualified for VA disability compensation. This total includes (1) $126 million in SSB payments, (2) $118 million in VSI payments, and (3) about $191 million in involuntary separation payments.

Making the repeal retroactive to veterans who separated since fiscal year 1992 would cost an additional $364 million, consisting of (1) $282 million in SSB payments, (2) $10 million in VSI payments already made plus about $37 million more committed to be paid over the life of the VSI pay period, and (3) $35 million in involuntary separation payments. Thus, a retroactive repeal could cost up to $799 million in additional separation pay.

[5]Other dual pay offsets also exist. For example, federal law offsets military retired pay and VA disability compensation, and federal civilian workers are prohibited from receiving both federal retirement benefits and workers' compensation or disability benefits for the same period of service.

[6]DOD expects to separate at least 91,000 more personnel from fiscal years 1995-97 through early retirement, involuntary retirement, reduced accessions, and other means.

The additional federal expenditure needed to pay for the offset repeal would be spread out over many years because much of the additional expenditure consists of the monthly disability payments that would no longer be withheld by VA.

Offsets' Effect on the Voluntary Separation Incentive

The offsets have not significantly undermined the separation incentive. According to DOD, less than 10 percent of all separations since fiscal year 1992 were involuntary, although DOD projects the proportion of involuntary separations to rise by 1999.[7] In addition, according to DOD, many involuntary separations consisted of normal losses needed to implement the up or out promotion system.

DOD officials stated that the services are required to inform separating service members of the requirements to (1) pay income tax on the gross amount of the separation pay and (2) repay the gross amount of the separation pay if they also receive disability compensation. While we did not attempt to verify that separating service members actually received this information, DOD provided evidence that it does require the services to include this information in a transition program for separating service members.

Agency Comments

As agreed with your offices, we did not seek formal agency comments on this report due to the short time frames. DOD and VA did provide oral comments on the report. Each generally agreed with the findings in our report and offered technical corrections, which were incorporated in the final text.

Scope and Methodology

We conducted our work in Washington, D.C., at DOD and VA. We reviewed department correspondence, instructions, manuals, and other documents and discussed these documents and other policy statements with officials from both departments. We also reviewed legislative histories, including congressional hearing records and committee and conference reports. In addition, we obtained information on the offset from officials of the Disabled American Veterans and the American Legion.

To estimate the number of service members who may separate and receive disability payments from fiscal years 1995-99, we adopted several critical

[7]The proportion of involuntary separations cited by DOD takes into account (1) reduced accessions, (2) voluntary early releases, (3) early retirements, (4) special early retirement boards, and (5) other separation authorities, as well as the separation authorities reviewed in this report.

assumptions and constructed an automated database consisting of DOD separation files and VA disability compensation case files.[8] First, we assumed that Congress and DOD will make no changes to the separation payment program, particularly that the payment formulas will not be changed and the program will neither be extended nor terminated early. Second, we assumed that the mix of separating service members will remain constant over time with respect to (1) years of service at time of separation, (2) basic pay at time of separation, (3) rank or grade at time of separation, (4) proportion of all separating service members who qualify for disability compensation, and (5) degree of disability of separating service members at the time of qualification for disability compensation. If any of those assumptions subsequently prove untrue, the actual cost of the separation program may change. DOD estimated the number of personnel likely to separate through the end of fiscal year 1997, and we accepted that estimate as the basis for our work. We estimated the number of personnel likely to separate in fiscal years 1998 and 1999 by extending the 1997 annual estimate through 1999, as suggested by DOD officials.

To estimate the value of future separation and disability pay, we first took the average paid out in each separation pay category in fiscal years 1992-94 and disability pay allocated at specified degrees of disability. We then adjusted the separation pay and disability compensation for 1992 and 1993 to reflect 1994 pay rates. We then calculated the 3-year averages for separation pay and disability compensation, and projected these averages to the population estimated to separate from fiscal years 1995-99. Our separation pay projections do not take into account military pay raises that may be granted in fiscal years 1995-99. If raises are granted, separation pay may be higher because base pay at the time of separation is a factor in calculating separation entitlements. Our disability pay projections were done assuming that no cost-of-living adjustment was granted from fiscal years 1995-99.

To estimate the cost to the government of repealing the offset, we used the database to identify those veterans who separated and received a separation payment and disability compensation in fiscal years 1992-94. We then totaled separation payments authorized to them to obtain the total value of pay that was offset. The result is the amount of additional expense that the government would incur if any repeal was made retroactive to fiscal year 1992. We then used our and DOD's projections on separations, years of service, grade at time of separation, and assumed

[8]We did not test the reliability of DOD's and VA's data or assess the adequacy of internal controls over their computer-based systems.

that 16 percent qualify for disability pay, as was the case in fiscal years 1992 and 1993, and applied a repeal of the offset to their estimated separation pay from fiscal years 1995-99.[9] The total amount of their separation pay represents the additional expense that the government would incur if the offset were repealed.

We conducted our work from November 1994 to March 1995 in accordance with generally accepted government auditing standards.

As agreed with your offices, we did not determine the impact of the offset on the affected veterans because verifiable data was not readily available.

As agreed with your offices, unless you publicly announce the contents earlier, we plan no further distribution of this report until 2 days after the date of this letter. At that time, we will send copies to other interested congressional committees; the Secretaries of Defense and Veterans Affairs; the Director, Office of Management and Budget; and Administrator, Internal Revenue Service. We will also make copies available to other interested parties upon request.

Please contact me on (202) 512-5140 if you or your staff have any questions. The major contributors to this report are listed in appendix II.

Mark E. Gebicke
Director, Military Operations
and Capabilities

[9]We did not include fiscal year 1994 disability case files in this calculation because the number of cases for fiscal year 1994 was unusually low at the time of our review. This may be caused by the amount of time it can take between separation from DOD and qualification for disability compensation with VA.

Contents

Letter		1
Appendix I Separation and Disability Pay Examples		10
	Separation Pay Examples	10
	Disability Pay Examples	11
Appendix II Major Contributors to This Report		13
Tables	Table I.1: Number of Actual and Estimated SSB, VSI, and Involuntary Separations, Fiscal Years 1992-99	10
	Table I.2: Illustrated Pay Options at Selected Grades and Years of Service	11
	Table I.3: Monthly VA Disability Compensation Paid to Recipients in October 1994	12

Abbreviations

DOD	Department of Defense
SSB	Special Separation Benefit
VA	Department of Veterans Affairs
VSI	Voluntary Separation Incentive

Separation and Disability Pay Examples

In fiscal years 1992-94, the Department of Defense (DOD) separated 108,333 service members and paid or committed to pay about $5.9 billion in special separation benefits (SSB), voluntary separation incentives (VSI), or involuntary separation pay. During fiscal years 1995-99, we estimate that about 25,700 service members will voluntarily separate and that DOD will involuntarily separate about another 59,700 service members, for a total of about 85,400 and authorize one of the three separation payments. We estimate that the federal government may spend about $2.7 billion on separation pay from fiscal years 1995-99. This total includes about (1) $789 million in SSB payments, (2) $734 million in VSI payments, and (3) about $1.2 billion in involuntary separation payments.

Table I.1 shows actual and estimated separations for fiscal years 1992-99 by SSB, VSI, or involuntary separation pay category.

Table I.1: Number of Actual and Estimated SSB, VSI, and Involuntary Separations, Fiscal Years 1992-99

Fiscal year	SSB	VSI	Involuntary	Total
1992	45,301	6,779	5,419	**57,499**
1993	17,986	5,089	8,267	**31,342**
1994	10,345	2,324	6,823	**19,492**
1995	17,566	3,419	11,642	**32,627**
1996	1,989	287	11,443	**13,719**
1997	784	22	12,207	**13,013**
1998[a]	780	20	12,200	**13,000**
1999[a]	780	20	12,200	**13,000**
Total	**95,531**	**17,960**	**80,201**	**193,692**

Note: Figures for 1995-99 are estimates.

[a]DOD did not project separations for fiscal years 1998 and 1999. On the basis of discussions with DOD officials, we rounded the estimated fiscal year 1997 figures and used them as estimates for fiscal years 1998 and 1999.

Separation Pay Examples

For fiscal years 1995-99, about 3,500 officers will each receive an average of $58,000, and about 18,400 enlisted personnel will each receive $31,900 as a lump sum payment for voluntary separation. In addition, about 600 officers will each receive about $11,700 annually (about $267,700 over about 23 years), and about 3,200 enlisted personnel will each receive about $6,900 annually (about $181,200 over about 26 years) for accepting a VSI.[1]

[1]The different VSI separation pay periods for officers and enlisted personnel reflect the different projections of years of service of each group at time of separation, which is an important factor in determining the total VSI compensation to be paid.

Service members that are involuntarily separated may receive an average of about $41,600 each for officers and about $16,000 each for enlisted personnel at full pay. Service members voluntarily separating can qualify for more separation pay than those that are involuntarily separated, as shown by the examples in table I.2.

Table I.2: Illustrated Pay Options at Selected Grades and Years of Service

		Pay options			
Grade	Years of service	Involuntary separation	SSB	VSI annual payment	Total VSI payment[a]
E3	7	$9,289	$13,936	$2,324	**$32,536**
E4	7	10,822	16,229	2,702	**37,828**
E6	12	24,492	36,742	6,120	**146,880**
O2	10	30,440	45,666	7,610	**152,200**
O4	14	60,788	91,168	15,190	**425,320**
O5	13	59,358	89,037	14,846	**385,996**

[a]The total VSI payment is the sum of the annual payments, which are paid for twice the number of years of service.

Of the 108,333 service members DOD has already separated, 11,784 had qualified for disability compensation from the Department of Veterans Affairs (VA) and were expected to have about $364 million of their separation pay offset, once recoupment is complete. In fiscal years 1992 and 1993, DOD separated 88,841 service members and authorized SSB, VSI, or involuntary separation payments. Of those service members, 13,836 (about 16 percent) had qualified for disability compensation from VA at the time of our review. Assuming that 16 percent of future separatees would also qualify for disability compensation, about 13,700 more service members would qualify for disability compensation from VA.

The average disability compensation ranged from about $87 to about $187 per month in fiscal year 1994 for those who also received separation pay. If the degree of disability of future recipients mirrors that of those who separated and received disability compensation in fiscal years 1992-94, the average disability payment will remain about the same unless Congress grants cost-of-living adjustments.

Disability Pay Examples

VA makes monthly payments to veterans on disability. Monthly disability payment amounts are set by Congress and related to degrees of disability (expressed in terms of percentages). Veterans receive larger monthly

payments for greater degrees of disability. In addition, disabled veterans may receive extra compensation for specified disabilities, for example, if they have lost a limb or eyesight, are bedridden, or (in certain circumstances) if they have dependents. Thus, the monthly amount paid to veterans will differ based on individual circumstances, even if the degree of disability is rated as the same.

In October 1994, VA made disability payments to 11,784 veterans who had separated from DOD and received an SSB, a VSI, or an involuntary separation payment in fiscal years 1992-94. Table I.3 shows the ranges of payments that these and other disabled veterans were receiving monthly or would begin receiving on repaying their separation payment.

Table I.3: Monthly VA Disability Compensation Paid to Recipients in October 1994

Degree of disability (percent)	Number of recipients	Basic pay	Maximum pay
10	43,825	$87	$157
20	19,820	166	253
30	11,897	253	706
40	7,008	361	1,879
50	2,870	515	1,004
60	2,023	648	2,062
70	804	819	2,227
80	409	948	2,171
90	125	1,067	2,241
100	1,450	1,774	5,414
Total	**90,231**		

Note: This table includes only those veterans who entered VA rolls from fiscal years 1992-94 and were on the rolls in October 1994. The table includes disabled veterans who never qualified for or received separation pay from DOD.

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