

TAX RELEASES

("Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. However, the answer may not apply to all questions of a similar nature. In situations where the facts vary from those given herein, it is recommended that advice be sought from the department. Unless otherwise indicated, Tax Releases apply for all periods open to adjustment. All references to section numbers are to the Wisconsin Statutes unless otherwise noted.)

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INDIVIDUAL INCOME TAXES

1. Distributions From IRAs Which Invest in U.S. Government Securities

Statutes: Section 71.05(6)(b)1, Wis. Stats. (1987-88)

Facts and Question 1: A Wisconsin resident establishes an individual retirement account (IRA). The amounts contributed to the IRA are invested in securities issued by the United States Government (e.g., U.S. Treasury bonds). When amounts are withdrawn from this IRA, will a portion of the amount withdrawn constitute interest from a United States Government security which is exempt from Wisconsin income tax?

Answer 1: Yes. The portion of the amount withdrawn from an IRA which is attributable to interest from U.S. Government securities may be excluded from Wisconsin taxable income. Federal law (31 USCS § 3124) prohibits states from taxing interest on United States Government obligations. An individual who receives distributions from an IRA which invests in U.S. Government securities is considered to have received exempt interest from a U.S. Government obligation. Section 71.05(6)(b)1, Wis. Stats. (1987-88), provides a subtraction from federal adjusted gross income for U.S. Government interest when computing Wisconsin taxable income.

Question 2: When U.S. Government interest is accumulated in an IRA, what portion of a distribution from the IRA is considered U.S. Government interest?

Answer 2: The portion of an IRA distribution which is considered U.S. Government interest is based on the following formula:

$$\begin{array}{r} \text{Amounts distributed} \\ \text{from all IRAs during} \\ \text{the year} \end{array} \times \frac{\begin{array}{l} \text{Total U.S. Government interest} \\ \text{received by the IRAs for all years} \\ \text{minus the amounts of U.S.} \\ \text{Government interest withdrawn} \\ \text{in prior years} \end{array}}{\begin{array}{l} \text{Total value of all IRAs at the end} \\ \text{of the year plus amounts} \\ \text{distributed during the year} \end{array}}$$

The following worksheet can be used to determine the portion of an IRA distribution which is considered U.S. Government interest. If the taxpayer has more than one IRA, they must be considered together, as if they were a single IRA, when completing the worksheet.

1. Amounts distributed from all IRAs during the year \$ _____
2. Total U.S. Government interest received by the IRAs for all years minus the amounts of U.S. Government interest withdrawn in prior years \$ _____
3. Total value of all IRAs at end of year plus amount on line 1 \$ _____
4. Divide line 2 by line 3. (Enter decimal figure.) _____
5. Multiply line 1 by line 4. This is the amount of the IRA distribution which is considered U.S. Government interest \$ _____

Example 1: A taxpayer has an IRA which has a fair market value of \$40,000 on December 31, 1988. Over the years, the taxpayer contributed \$25,000 of deductible contributions to the IRA and the IRA was credited with \$10,000 of interest from U.S. Government securities and \$11,000 of other interest. During 1988, the taxpayer received a distribution of \$6,000 from the IRA. The

taxpayer did not receive any distributions in prior years. The Wisconsin subtraction for U.S. Government interest for 1988 is \$1,304.40, computed as follows:

1. Amounts distributed from all IRAs during the year	\$6,000.00
2. Total U.S. Government interest received by the IRAs for all years minus the amounts of U.S. Government interest withdrawn in prior years	\$10,000.00
3. Total value of all IRAs at end of year plus amount on line 1 (\$40,000.00 + \$6,000.00)	\$46,000.00
4. Divide line 2 by line 3	.2174
5. Multiply line 1 by line 4. This is the amount of the IRA distribution which is considered U.S. Government interest.	\$1,304.40

Example 2: During 1989, the taxpayer in Example 1 receives an additional distribution of \$8,000 from the IRA. No additional contributions are made to the IRA during 1989. Interest income credited to the IRA during 1989 is \$4,000 of which \$1,800 is interest from U.S. Government securities and \$2,200 is other interest. The fair market value of the IRA on December 31, 1989, is \$36,000. The Wisconsin subtraction for U.S. Government interest is \$1,908, computed as follows:

1. Amounts distributed from all IRAs during the year	\$8,000.00
2. Total U.S. Government interest received by the IRAs for all years minus the amounts of U.S. Government interest withdrawn in prior years (\$10,000.00 + \$1,800.00 - \$1,304.40)	\$10,495.60
3. Total value of all IRAs at the end of the year plus amount on line 1 (\$36,000.00 + \$8,000.00)	\$44,000.00
4. Divide line 2 by line 3	.2385
5. Multiply line 1 by line 4. This is the amount of the IRA distribution which is considered U.S. Government interest.	\$1,908.00

Question 3: How is the portion of an IRA distribution which is considered U.S. Government interest determined where both deductible and nondeductible contributions are made to the IRA?

Answer 3: The above worksheet may also be used when nondeductible contributions are made to an IRA which invests in U.S. Government securities. The total nondeductible contributions should be included with the U.S. Government interest on line 2. This results in the amount of the distribution which is not taxable

to Wisconsin. The portion which is attributable to U.S. Government interest is the difference between the amount taxable for federal purposes and the amount taxable for Wisconsin purposes.

Example: A taxpayer has an IRA which has a fair market value of \$60,000 on December 31, 1988. Over the years, the taxpayer contributed \$40,000 of deductible contributions and \$2,000 of nondeductible contributions to the IRA, and the IRA was credited with \$20,000.00 of interest from U.S. Government securities and \$8,000 of other interest. During 1988, the taxpayer received a distribution of \$10,000.00 from the IRA. Of this amount, \$9,700 is included in federal adjusted gross income. The taxpayer did not receive any distribution in prior years. The Wisconsin subtraction for U.S. Government interest for 1988 is \$2,843, computed as follows:

1. Amounts distributed from all IRAs during the year	\$10,000.00
2. Total nondeductible contributions and U.S. Government interest received by the IRAs for all years minus any tax-free withdrawals in prior years	\$22,000.00
3. Total value of all IRAs at end of year plus amount on line 1 (\$60,000.00 + \$10,000.00)	70,000.00
4. Divide line 2 by line 3	.3143
5. Multiply line 1 by line 4. This is the total amount not taxable for Wisconsin.	<u>3,143.00</u>
6. Subtract line 5 from line 1. This is the amount of the IRA distribution that must be included in Wisconsin income.	\$ 6,857.00
Amount of IRA distribution included in federal adjusted gross income	\$ 9,700.00
Less amount to be included in Wisconsin income	<u>6,857.00</u>
Allowable subtraction for U.S. Government interest	\$ 2,843.00

2. Employee Benefit Plans: Unrelated Business Taxable Income

Statutes: Section 71.01(6), Wis. Stats. (1987-88)

Note: This Tax Release applies only with respect to taxable years 1988 and thereafter.

Background: Under sec. 501(a) and (c)(9) of the Internal Revenue Code (IRC), voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to

the members of such association or their dependents or designated beneficiaries are exempt from federal income tax if no part of the associations' earnings inures to the benefit of any private shareholder or individual. However, such associations are taxed on their unrelated business taxable income for federal tax purposes under sec. 511, IRC.

Question: Are voluntary employees' beneficiary associations subject to Wisconsin franchise or income tax on their unrelated business taxable income?

Answer: No. Although sec. 71.01(6), Wis. Stats. (1987-88), would require voluntary employees' beneficiary associations to report their unrelated business taxable income for Wisconsin tax purposes, 29 U.S.C. § 1144(a), preempts such taxation by Wisconsin.

Title 29 U.S.C. § 1144(a) was created by the Employee Retirement Income Security Act of 1974 (ERISA) and provides that ERISA supersedes any and all state laws insofar as they relate to any employee benefit plan.



3. Itemized Deduction Credit and School Property Tax Credit: Business Use of the Home

Statutes: Sections 71.07(5) and (9), Wis. Stats. (1987-88)

Note: This Tax Release applies only with respect to taxable years 1987 and thereafter.

Background: For federal tax purposes, an employe may claim an itemized deduction for unreimbursed office-in-the-home expenses on Schedule A. Beginning with the 1987 tax year, unreimbursed home office expenses, other than taxes, interest, and casualty losses, are subject to the 2% of federal adjusted gross income limitation and are claimed as a miscellaneous itemized deduction on federal Schedule A. Taxes, interest, and casualty losses are not subject to the 2% limitation and are deducted on the appropriate lines (i.e., interest with home mortgage interest, taxes with other real estate taxes, and casualty losses with other casualty losses) on Schedule A.

For Wisconsin tax purposes, certain amounts claimed as itemized deductions on federal Schedule A are used to compute the Wisconsin itemized deduction credit. Interest amounts from federal Schedule A which are used in computing the Wisconsin itemized deduction credit include (1) interest paid on a principal residence, (2) interest paid on a second home located in Wisconsin, (3) interest paid on a land contract, and (4) other interest, but not exceeding \$1,200 (\$600 if married filing a separate return). Real estate taxes paid are not used to compute the Wisconsin itemized deduction credit. However, real estate taxes paid on a principal residence are used to determine the school property tax credit.

Question 1: When an employe claims a federal itemized deduction for unreimbursed home office expenses, is the entire amount of home mortgage interest on federal Schedule A considered interest on a principal residence for purposes of the Wisconsin itemized deduction credit?

Answer 1: No. The portion of the home mortgage interest related to business use retains its character as a business expense. Only the personal portion of the mortgage interest expense on the residence is fully used when computing the Wisconsin itemized deduction credit. The portion of the mortgage interest expense related to business use of the home is combined with "other interest" and is subject to the \$1,200 limitation (\$600 if married filing a separate return).

Note: If the amount of interest expense for a principal residence was paid on a land contract rather than on a mortgage, all of the amount of interest paid is used to compute the Wisconsin itemized deduction credit. Section 71.07(5)(a)7, Wis. Stats. (1987-88), provides that land contract interest is not subject to the \$1,200 limitation.

Example: A single taxpayer is an employe who works in his or her home for the convenience of the employer. Twenty percent of the home is used regularly and exclusively for this business purpose. The taxpayer reports 20% of the cost of maintenance, insurance, and utilities and depreciation as a miscellaneous itemized deduction on federal Schedule A (subject to the 2% of federal adjusted gross income limitation). The taxpayer paid \$3,000 for interest on the home mortgage and \$1,200 for real estate taxes on the home during the year. These amounts are reported as deductible home mortgage interest and real estate taxes on federal Schedule A. The taxpayer may use \$2,400 (\$3,000 x 80%) as interest paid on a principal residence when computing the Wisconsin itemized deduction credit. The business portion of the home mortgage interest is combined with "other interest" and up to \$1,200 of the total is used to compute the Wisconsin itemized deduction credit.

Question 2: When an employe claims an itemized deduction on federal Schedule A for home office expenses, is the entire amount of real estate taxes paid during the year used when determining the home owner's school property tax credit?

Answer 2: No. Section 71.07(9)(a)3, Wis. Stats. (1987-88), defines property taxes for purposes of the school property tax credit as the property taxes paid on a claimant's principal dwelling "less any property taxes paid which are properly includable as a trade or business expense under section 162 of the internal revenue code." Thus, the property taxes paid must be reduced by the amount allocated as taxes paid for business use of the residence before determining the home owner's school property tax credit. In the above example, \$960 (\$1,200 x 80%) is used as real estate taxes paid on a principal residence to determine the school property tax credit.



4. Taxation of Lottery Winnings

Statutes: Sections 71.01(6)(c), 71.04(1)(a), 71.07(7), and 71.67(4), Wis. Stats. (1987-88)

Note: This Tax Release applies only with respect to taxable years 1988 and thereafter.

Background: Federal law provides that winnings from lotteries are gambling winnings and must be included in taxable income. If winnings from a state lottery are payable in installments, the annual payments must be included in taxable income. These same provisions apply for Wisconsin residents under sec. 71.01(6)(a) to (c), Wis. Stats. (1987-88).

Nonresidents are taxed on winnings from the Wisconsin lottery under sec. 71.04(1)(a), Wis. Stats. (1987-88).

A lottery ticket can be effectively assigned to another person, in whole or in part, for tax purposes. The assignment must occur before the determination that the ticket is a winning ticket. If it is assigned after determining the ticket is a winner, the donor (original owner) of the ticket remains liable for the income tax on the total winnings.

Section 71.67(4), Wis. Stats. (1987-88), provides that the executive director of the lottery must withhold Wisconsin income tax on winnings from the Wisconsin lottery if such winnings are \$2,000 or more. The amount withheld is computed by multiplying the lottery winnings by the highest tax rate applicable to individuals (6.93% for the 1988 taxable year).

Question 1: If a Wisconsin resident wins a lottery run by another state, is that income subject to Wisconsin income tax?

Answer 1: Yes. Lottery winnings won by a Wisconsin resident from any state's lottery are subject to Wisconsin income tax under sec. 71.04(1)(a), Wis. Stats. (1987-88).

Question 2: If lottery winnings are taxable to a Wisconsin resident by both Wisconsin and another state, is there any relief from paying tax on the income twice?

Answer 2: Yes. Section 71.07(7), Wis. Stats. (1987-88), provides that if a Wisconsin resident pays net income tax to another state, that resident may claim a credit against Wisconsin net tax for the amount of the net tax paid to the other state. The credit is not allowed unless the lottery winnings are taxed by both states.

Example: Taxpayer A, a resident of Wisconsin, wins \$10,000 in the Illinois lottery. Taxpayer A pays \$500 of Illinois income tax on the \$10,000 of lottery winnings. Taxpayer A may claim a credit on his or her Wisconsin income tax return of \$500 for the tax paid to Illinois.

Question 3: Taxpayer A buys a Wisconsin lottery ticket that wins \$500. After A determines the ticket is a winner, A gives the ticket

to Taxpayer B. Must Taxpayer B include the \$500 in his or her Wisconsin taxable income?

Answer 3: No. Because Taxpayer A knew that the ticket was a winner before giving it to Taxpayer B, Taxpayer A must include the \$500 in his or her Wisconsin taxable income.

Question 4: Can two or more persons share in the winnings from a Wisconsin lottery ticket and, therefore, each report a portion of the lottery winnings as taxable income?

Answer 4: Yes. Two or more persons may share the lottery winnings from a single lottery ticket. If several persons agree to share in possible winnings from a Wisconsin lottery ticket, the amount of the winnings is reportable as taxable income by the person or persons who "own" the ticket at the time the drawing or other event that determines the winner takes place. An agreement to share in the lottery winnings made after the winnings have been determined will not allow the persons to share in the taxability of such winnings.

Example 1: Taxpayer A and Taxpayer B buy a Wisconsin lottery ticket, each paying 50¢ for the ticket. The ticket is a \$5,000 winner. Taxpayer A and Taxpayer B would each report \$2,500 as taxable income.

Example 2: Taxpayer A buys a Wisconsin lottery ticket, scratches the ticket, and determines it is a \$5,000 winner. Taxpayer A then agrees to share the winnings equally with Taxpayer B. Taxpayer A must report \$5,000 as taxable income because the agreement to share the winnings was made after the winnings had been determined.

Question 5: Taxpayer A, Taxpayer B, and Taxpayer C buy a Wisconsin lottery ticket together and agree to share equally in any winnings. They determine that the ticket is a \$5,000 winner. Will Wisconsin income tax be withheld from the winnings?

Answer 5: Yes. Section 71.67(4), Wis. Stats. (1987-88), provides that Wisconsin income tax must be withheld on any lottery prize of \$2,000 or more. The term "lottery prize" refers to the total prize paid on a particular lottery ticket and not the amount of winnings each person will receive.

Note: The Lottery Board will issue only one check per winning ticket even though several people may be sharing in the lottery winnings. The amount paid, if over \$2,000, will be reduced by any income tax withheld.

Question 6: Will a taxpayer receive an information return regarding lottery winnings?

Answer 6: Yes. Under federal law, the Lottery Board is required to issue Form W-2G, "Certain Gambling Winnings" to any person to whom it pays winnings of \$600 or more if such winnings are at least 300 times the amount of the single wager. Any Wisconsin income tax withheld will be shown on the Form W-2G.

Question 7: Will the Lottery Board issue more than one Form W-2G if several persons share in the lottery winnings?

Answer 7: Yes, provided the person who received the lottery winnings files federal Form 5754, "Statement by Person(s) Receiving Gambling Winnings," with the Lottery Board. Form 5754 is used to notify the Lottery Board, as payer of the lottery winnings, of any persons, other than the person receiving the gambling winnings, that are subject to withholding or reporting requirements because they were entitled to part of the winnings.

Form 5754 should be filed with the Lottery Board prior to the close of the calendar year in which the winnings were paid. This gives the Lottery Board sufficient time to issue any Forms W-2G prior to their due date of January 31 following the year in which the winnings are paid.

Example: In 1988, Taxpayers A, B, and C agree to share equally in the winnings of a Wisconsin lottery ticket. The taxpayers can prove that this agreement was reached prior to scratching off the appropriate spaces on the ticket. The ticket is a winner of \$5,000. Therefore, the total prize of \$5,000 is subject to Wisconsin withholding at the rate of 6.93% or total withholding of \$346.50.

Taxpayer A redeems the ticket with the Lottery Board and is issued a check of \$4,653.50 (\$5,000 – \$346.50) and shares the amount with B and C. Provided Taxpayer A files Form 5754 with the appropriate information, Taxpayers A, B, and C will each receive an information return (Form W-2G) showing a taxable amount of winnings of \$1,666.66 ($\$5,000 \div 3$) and Wisconsin withholding of \$115.50 ($\$346.50 \div 3$).

Withholding is shared in the same proportion as the lottery prize.



5. Waiver of Interest on Underpayment of Estimated Tax

Statutes: Sections 71.09(11)(c) and (d) and 71.84(1), Wis. Stats. (1987-88)

Background: For the 1988 taxable year and thereafter, no interest on underpayment of estimated tax will be assessed to individuals and fiduciaries if certain conditions apply as determined by the Secretary of Revenue. Section 71.09(11)(c) and (d), Wis. Stats. (1987-88), provides:

“(11) EXCEPTIONS TO INTEREST. No interest is required under s. 71.84(1) if any of the following conditions apply:

(c) The secretary of revenue determines that because of casualty, disaster, or other unusual circumstances it is not equitable to impose interest.

(d) The secretary of revenue determines that the taxpayer retired during the taxable year or during the preceding taxable year after having attained age 62 or becoming disabled and that the underpayment was due to reasonable cause and not due to wilful neglect.”

Question 1: How does an individual or fiduciary apply for a waiver of interest on underpayment of estimated tax?

Answer 1: An individual or fiduciary may apply for a waiver of the interest on underpayment of estimated tax by completing Schedule U and writing the word “WAIVER” in the bottom margin of page 1 of the schedule. The individual or fiduciary must also attach an explanation to the schedule and show how much of the underpayment interest is to be waived. The Schedule U and explanation should be attached to the Wisconsin income tax return when it is filed.

If an individual or fiduciary is applying for a waiver of the interest on underpayment of estimated tax for the entire year, a Schedule U need not be completed. Rather, the individual or fiduciary may apply for a waiver by attaching an explanation to the Wisconsin income tax return when it is filed. The explanation should be clearly titled as an “Application for Waiver of Interest on Underpayment of Estimated Tax.”

The department will review the application for waiver of the interest on underpayment of estimated tax when the return is computer processed. The individual or fiduciary will receive an adjustment notice if the application is denied or denied in part.

If an individual or fiduciary does not apply for the waiver with the tax return, interest on underpayment of estimated tax may be assessed by the department. The individual or fiduciary could then apply for a waiver by filing a written objection to the assessment within 60 days of receipt of an adjustment notice. The individual or fiduciary should explain the reasons why a waiver is requested and show how much of the underpayment interest should be waived.

The department will review a written objection to an assessment and determine how much, if any, of the underpayment interest will be waived. The individual or fiduciary may further appeal the department’s decision, in which case the application for waiver and appeal will be referred to the Appellate Bureau.

Question 2: What are the department’s guidelines for waiving interest on underpayment of estimated tax in cases of casualty, disaster, or other unusual circumstances?

Answer 2: Upon application by the taxpayer, the department will consider each case on its merits. The department may waive a portion of the interest on underpayment of estimated tax as explained below. The number of payments for which interest will be waived will be determined based on the circumstances in each case.

Interest may be waived on estimated tax payments due after:

1. A natural disaster occurred (e.g., tornado, flood, fire, etc.).
2. Onset of a debilitating illness or injury (e.g., stroke, heart attack, cancer, auto accident, etc.) of the taxpayer or an immediate family member.
3. The taxpayer entered a nursing home or other treatment facility.
4. The taxpayer requested his or her employer to withhold Wisconsin tax and the employer incorrectly withheld another state tax.
5. The taxpayer first began working in a reciprocal state where the employer withheld the tax of the reciprocal state rather than Wisconsin tax.
6. The taxpayer moved to Wisconsin from a reciprocal state where the employer continued to withhold the tax of the reciprocal state rather than Wisconsin tax.

Question 3: What are the department's guidelines for waiving interest in retirement cases?

Answer 3: Upon application by the taxpayer, the department will consider each case on its merits. The taxpayer must meet all of the statutory requirements before interest can be waived. Retirement alone is not enough to excuse the interest on underpayment; the taxpayer must show reasonable cause for not making the required estimated tax payments. Also, other income sources will be considered in determining how much, if any, of the interest will be waived.

The department may waive a portion of the interest on underpayment of estimated tax as explained below. The number of payments for which interest will be waived will be determined based on the circumstances in each case.

Interest may be waived on estimated tax payments due after:

1. Retirement if the taxpayer thought state tax was being withheld from retirement income because federal tax was being withheld.
2. Retirement if the taxpayer was provided incorrect information about the tax treatment of his or her retirement income by the employer or other payer.
3. Onset of a disabling illness or injury that leads to retirement.

Question 4: Will any other unusual circumstances be considered for purposes of waiving interest on underpayment of estimated tax?

Answer 4: The department will consider each case on its merits. The circumstances must be unusual, though, in the same way that a casualty or disaster is unusual. The department will not waive interest in cases where the taxpayer was not aware of estimated tax payment requirements.



HOMESTEAD CREDIT

1. VEAP Payments As Household Income

Statutes: Section 71.52(6), Wis. Stats. (1987-88)

Wis. Adm. Code: Section Tax 14.03(2)(b), February 1980 Register

Background: Under sec. 71.52(6), Wis. Stats. (1987-88), compensation and other cash benefits received from the United States for past or present service in the armed forces is includable in income for homestead credit purposes.

The Voluntary Educational Assistance Program (VEAP) was a program available to persons who joined the active duty U.S. military service between January 1, 1977, and June 30, 1985, and whose contributions in the program commenced before April 1, 1987. Participation in the program was voluntary, and an individual's contributions had to be at least \$25 per month but no more than \$100 per month, though a "lump-sum" contribution was permissible. The total amount which could be contributed was \$2,700, and the armed forces matched the individual's contributions at the rate of \$2 for each \$1 contributed. Also, additional contributions called "kickers" could be added by the armed forces, as an enlistment incentive or for other similar reasons.

The monthly distribution equals the total amount available (contribution plus matching amounts plus kickers) divided by the number of months the person made contributions, but the total monthly allocation cannot exceed \$300. That allocation is then prorated if the person is less than a full-time student. The payments are made directly to the veteran based on this formula, not based on tuition costs, etc., and no interest accrues on any portion of VEAP payments. Each monthly payment consists partly of the individual's contribution and partly of the armed forces' contribution (for example, if there were no kickers, the monthly payment would consist of 1/3 the individual's contribution and 2/3 the armed forces' contribution).

Upon request, the U.S. government will pay back to the veteran the portion of the veteran's contribution not used for educational purposes, even 100% if the veteran so wishes, but without interest.

Question: Are VEAP payments includable in household income for homestead credit purposes?

Answer: The portion of VEAP payments constituting a claimant's contribution is not considered household income, since the program is similar to a type of savings account which can be recovered with no restrictions. However, the portion of VEAP payments constituting the United States government's contribution is household income for homestead credit purposes, as compensation or other cash benefits received from the United States for past service in the armed forces.