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The Tax Map of Your Paycheck

A Sirmium Research Letter · For Veterans and Federal Retirees

William Harrison, Founder and Chief Investment Officer · July 2026

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From William Harrison, Founder and Chief Investment Officer, Sirmium Capital

Your retirement paycheck is not one stream taxed one way. It arrives in pieces, and each piece follows its own rule. Sort the pieces onto a simple map, tax-free, taxable, and partly taxable, and two things become clear: how much of the check is really yours to keep, and why the order you draw matters as much as the rates.

The tax-free pieces

Start with the clearest line on the map. VA disability compensation is excluded from income at every rating, from 10 percent to 100 percent. No 1099, no federal income tax, and no state income tax either.

Two other pieces are tax-free for their own reasons. CRSC, Combat-Related Special Compensation, is tax-free, though it is limited to combat-related disabilities and must be applied for through your branch. Qualified withdrawals from a Roth TSP also come out tax-free, because the tax was already paid on the way in.

The taxable pieces

Military retired pay is taxable as ordinary federal income. So is a traditional TSP withdrawal, because those dollars went in before tax and the tax comes due when you draw them. A civil-service FERS annuity is likewise taxed as ordinary income.

CRDP, Concurrent Retirement and Disability Pay, is the one people mix up. It restores waived retired pay for retirees with 20 or more years of service and a combined VA rating of 50 percent or higher, and because it is restored retired pay, it is taxable. You cannot receive CRDP and CRSC at the same time, so which you elect is a real-dollars decision that turns on your own numbers. That is a question for your advisor and tax professional, not a rule of thumb.

The partly taxable piece

Social Security sits in its own zone. A portion of the benefit can be taxable at the federal level, and how much depends on your total income for the year.

There is good news for career military and federal retirees. The old WEP and GPO rules that once reduced some government retirees' Social Security were repealed for benefits payable from 2024 onward, and military and FERS service was always Social-Security-covered anyway, so your pension does not cut your own benefit. What remains is that the taxable share of your Social Security rises with your other income, which is exactly why the order you draw your streams matters.

> **The one line worth keeping.** Not every dollar of your retirement paycheck is taxed the same. Sort your streams into tax-free, taxable, and partly taxable before you decide which to draw first.

Where your state sits on the map

State of residence is one of the largest levers, and unlike your rating or your service history, it is sometimes one you can choose. Two retirees with identical federal returns can owe very different state tax simply by where they live.

New York fully exempts United States military retired pay and federal pensions, including the FERS annuity and the federal Thrift Savings Plan kept in the plan, with no cap, and it does not tax Social Security. Other retirement income, such as private pensions and annuities, can qualify for a separate $20,000 exclusion once you reach 59 and a half. Connecticut exempts 100 percent of military retired pay with no age or income test, exempts Social Security for retirees under its income thresholds, and gives a separate deduction that phases out for other pension and IRA income as income rises.

Why the order you draw matters

The map is not only about which pieces are taxable. It is about when you touch them. Three timing levers do most of the work.

The pre-59 and a half bridge. The 10 percent early-withdrawal penalty on the TSP does not apply if you separate from federal service in or after the year you turn 55, and the threshold drops to age 50, or 25 years of service, for qualified public safety roles. Knowing your own penalty-free date changes which account you should touch first.

IRMAA's two-year memory. Your Medicare premium looks back two years at your income, so a large traditional-to-Roth conversion in 2026 can raise your 2028 premium. The conversion can still be the right move; the point is to see that bill before it arrives.

Required withdrawals. Traditional balances eventually force taxable withdrawals starting at age 73, rising to 75 for those born in 1960 or later, whether or not you need the cash that year. The low-income years before then are often where the planning earns its keep.

What to do with the map

The map tells you the terrain. It does not tell you your route. Your bracket, your state, your rating, your penalty-free date, and your required-withdrawal horizon are all personal, and the right sequence is the one built around them. The practical move is to lay your own streams on the map, then work the taxable-versus-tax-free order and the conversion timing with your tax professional before you commit.

Our free Veterans calculator lays the pension, VA, TSP, and state pieces out side by side, with no email required to see your result. And a 15-minute call is a plain conversation about your paycheck and the order to draw it.

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Sources. IRS Publication 525 and IRC Section 104(a)(4) (VA disability excluded from income); DFAS CRDP and CRSC guidance (CRDP taxable, CRSC tax-free, one-or-the-other election); New York Department of Taxation and Finance (military and federal pensions exempt; the $20,000 exclusion at 59 and a half); Connecticut OLR Report 2025-R-0152 (military pay and pension treatment); TSP Bulletin 23-3 (the age-55 and public-safety early-withdrawal rules). Rules and figures are subject to change; confirm the specifics with your own tax professional.