

Anthony P. Curatola, Editor

Tax Benefits for Military Members and Families, Part 2

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▶ Last month we took a peek at the tax benefits available to military members and their families—more specifically, whether an item of income is *includible* in gross income (i.e., taxable) or *excludible* (not taxable). This month we continue our discussion by exploring the special allowances for itemized deductions and the provisions of The Military Family Tax Relief Act of 2003,

including the special allowances for gain on sale of personal residence, tax forgiveness, and filing deadlines.

When arriving at taxable income, a taxpayer deducts either the standard deduction or itemized deductions from their adjusted gross income (AGI). A taxpayer may also deduct miscellaneous itemized deductions, such as unreimbursed employee business expenses, in an amount that exceeds 2% of AGI (IRC §67(a)). For a member of the Armed Forces, unreimbursed employee business expenses take on a whole new meaning.

Itemized deductions. To begin with, a taxpayer is permitted to deduct unreimbursed travel expenses if they are incurred while the taxpayer is traveling away from home (IRC

§162(a)(2), Treasury Reg. §1.162-2).

A member of the Armed Forces on permanent duty assignment overseas is *not* considered to be traveling away from home. As such, the member isn't permitted to deduct meals and lodging expenses related to the permanent duty assignment. This is true even if the member maintains a residence in the United States. More importantly, the travel expenses must be related to work in order to be deductible. Hence, expenses incurred for visiting family while on leave or liberty aren't deductible.

So what does home mean to a member of the Armed Forces? Home is the member's permanent duty station, regardless of where the member or his/her family lives. As such, members of the Armed Forces are

away from home if they are away from their permanent duty station "substantially longer than an ordinary day's work."

IRS Publication 3 provides the following examples of deductible travel expenses:

- Expenses for business-related meals, lodging, taxicabs, business telephone calls, tips, laundry, and dry cleaning while away from home on temporary duty or temporary additional duty, and
- Expenses of carrying out official business while on "No Costs" orders.

Transportation costs incurred in getting from one work location to another while a member is on duty (not while traveling from home) *are* deductible. As outlined in IRS Publication 3, transportation expenses *include* the costs of transportation by air, bus, rail, taxi, and driving as well as maintaining the member's car. Moreover, if a military member has a temporary work location, the expenses incurred while traveling to the temporary work location are deemed *deductible* transportation expenses. Generally, if the employment at a new work location is realistically expected to last for one year or less (and does), the employment is deemed

temporary. Therefore, the work location is also temporary. The interesting tidbit to this provision is that if the employment is expected to last for more than one year—and, therefore, isn't classified as temporary—but ends up lasting less than one year, the work location is still not classified as temporary (Rev. Rul. 93-86)!

If a member of the Armed Forces reserve unit is required to attend a meeting that is held on a day in which that member would normally be at his or her regular job, the expenses of attending the meeting are deductible. On the flip side, if the meeting is scheduled on a day that the member would not be working the regular job, the expenses are considered to be commuting expenses and, therefore, are *not* deductible.

Generally, a taxpayer is *not* permitted a deduction for the cost and upkeep of work attire if the attire is also worn outside the workplace. These rules also apply to military uniforms that can be worn when off duty. If military regulations prohibit a member from wearing certain uniforms off duty, however, the cost and upkeep of those uniforms *are* deductible less any allowance or reimbursements that are received.

Members of the Armed Forces and their families gained a number of new tax benefits when The Military Family Tax Relief Act of 2003 was signed into law by President Bush on November 11, 2003. Among its provisions are the tax breaks related to military personnel we just discussed as well as death benefits, sale of principal residence, deduction for overnight travel expenses of National Guard and Reserve members, and combat zone extensions expanded to contingency operations.

Death benefits. A survivor of a member of the Armed Forces who

died after September 10, 2001, is eligible to receive \$12,000 in death benefits. The entire \$12,000 is excludible from gross income and thus nontaxable. Prior to this change, the death gratuity amount was \$6,000, of which only \$3,000 was excludible from gross income. An amended return can be filed to claim a refund if a taxpayer paid taxes on a death gratuity received for a death occurring after September 10, 2001.

Sale of principal residence. Under IRC §121(b), a taxpayer may exclude from gross income \$250,000 (\$500,000 if married filing jointly) of realized gain on the sale of their principal residence if certain requirements are met. Generally, gain may only be excluded if, during the five-year period ending on the date of the sale, the taxpayer owned the home for at least two years *and* lived in the home as his or her principal residence for at least two years.

The Military Family Tax Relief Act created an exception to the “two-out-of-five” requirement for military personnel on qualified official extended duty in the U.S. That is, the person may disregard up to 10 years of the extended duty time when looking at the five-year ownership and use period.

Example: Patty maintained a principal residence for three years up to December 28, 2000, when she left on qualified official extended duty with the Army. On May 1, 2005, Patty sold her home for a gain. Because she did not maintain the home as her principal residence for two years during the past six years, Patty chooses to suspend the time that she was on qualifying official extended duty. As a result, she satisfies the two-year principal residence test during the five-year period of December 27, 1995, to December 28, 2000. Consequently, she can exclude

up to \$250,000 in gain.

Qualified official extended duty is extended duty that is either served at a duty station at least 50 miles from the taxpayer's main home or served living in government quarters under government orders.

Deduction for overnight travel expenses of National Guard and Reserve members. If a reservist is required to stay overnight more than 100 miles away from home while in service (e.g., for a drill or meeting), the individual is eligible to deduct unreimbursed travel expenses, such as transportation, meals, and lodging. Better yet, beginning in 2003 these deductions are taken as an above-the-line deduction and are *not* subject to the 2% floor for itemized deductions.

Tax forgiveness. If a member of the Armed Forces dies while in active service in a combat zone or from wounds, disease, or other injury received in a combat zone, the decedent's income tax liability for the year of death as well as any earlier tax year ending on or after the first day the member served in a combat zone in active service is forgiven. If any forgiven tax liability has already been paid, it will be refunded, and any unpaid tax liability at the date of death will be forgiven.

Extension of time to file. Taxpayers are able to receive an extension of time to file their tax return beyond the April 15 deadline. The extension is for the filing of the tax return only and *not* the payment of taxes. The deadline for an Armed Forces member for filing tax returns, as well as *paying taxes*, filing claims for refunds, and taking other actions with the IRS is *automatically* extended if any of the following criteria are met:

- The member is serving in a combat zone or has a qualifying service outside a combat zone,

- The member is serving in a qualified hazardous duty area or is deployed overseas away from his or her permanent duty station in support of operations in a qualified hazardous duty area but the deployment station is outside the qualified hazardous duty area, or

- The member is on deployment outside the U.S. away from his or her permanent duty station while participating in a contingency operation.

Under the above conditions, the taxpayer's deadline is extended for 180 days after the later of:

- The last day in a combat zone, having service outside the combat zone, or serving in a contingency operation, or

- The last day of any continuous qualified hospitalization for injury from service in the combat zone or contingency operation or while performing qualifying service outside the combat zone.

What does all this mean? As client lists become more and more diversified, practitioners need to continuously update their knowledge of the tax law and how it relates to each taxpayer, separately, in order to competently service their clients. Education and knowledge are key in helping taxpayers save tax dollars! ■

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