

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is centered in the narrow neck of the hourglass. The text is centered within the hourglass shape.

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Military Family Tax Relief Act of 2003

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Summary

The Military Family Tax Relief Act of 2003, H.R. 3365, became P.L. 108-121 on November 11, 2003. The Act provides various types of tax relief to members of the Armed Forces. Additionally, the Act suspends the tax-exempt status of organizations involved in terrorist activities, offers tax relief to astronauts who die in the line of duty, and extends the authorization for certain customs user fees.

The Military Family Tax Relief Act of 2003, H.R. 3365, contains a variety of measures that are primarily intended to provide tax relief to members of the Armed Forces. The House of Representatives voted unanimously in favor of the bill on October 29, 2003. The Senate passed a significantly amended version by unanimous consent on November 3 and the House unanimously approved the Senate amendments on November 5. President Bush signed the bill into law, P.L. 108-121, on November 11, 2003.

Measures Providing Tax Relief to Members of the Military

Expanded eligibility to exclude gain from the sale of a principal residence (sec. 101). Under section 121 of the Internal Revenue Code (IRC), an eligible taxpayer may exclude from gross income up to \$250,000 (\$500,000 if married filing jointly) of the gain realized from the sale of his or her principal residence. One eligibility requirement is that the taxpayer must have used the property as a principal residence for at least two of the five years preceding the date of sale. The Act amends section 121 so that a taxpayer may elect to suspend the five-year period for up to ten years during the time that the taxpayer or the taxpayer's spouse is on qualified official extended duty.¹ Qualified duty is serving for more than 90 days or an indefinite period at a duty station that is at least 50 miles from the residence or while residing under orders in Government quarters. The new rule applies to sales and exchanges made after May 6, 1997. Since taxpayers are generally unable to amend returns more than three years after

¹ Members of the Foreign Service also qualify to make the election.

the original filing date or two years after the tax was paid,² the Act grants taxpayers one year to file for a refund even though it may otherwise be barred. The one-year period began on November 11, 2003.

Exclusion of the military death benefit from gross income (sec. 102).

Under IRC § 134, qualified military benefits are excluded from gross income. The exclusion is limited to benefits that (1) are made on account of the taxpayer's status or service as a member of the Armed Forces and (2) were excusable on September 9, 1986. Any benefit increase after September 9, 1986 is included in income, unless it is a cost-of-living adjustment or similar increase. The death gratuity payment made to the survivors of members of the Armed Forces who die while on active duty is a qualified military benefit.³ The payment was \$3,000 on September 9, 1986 and it was later increased to \$6,000. Thus, prior to the Act, the \$3,000 increase was included in income.

The Act makes two changes related to the death gratuity payment. First, the benefit is increased from \$6,000 to \$12,000. Second, the entire payment, including any future increases, is excluded from gross income. The changes apply for all deaths occurring after September 10, 2001.

Exclusion of payments made to offset the negative effect of base closure on housing values (sec. 103). Under the Homeowners Assistance Program found in 42 U.S.C. § 3374, the Department of Defense may offer payments to members of the Armed Forces whose housing values have decreased due to military base realignment or closure. Prior to the Act, such payments did not qualify for exclusion from gross income. The Act amends IRC § 132 so that payments made after November 11, 2003 are nontaxable fringe benefits, subject to limitation by 42 U.S.C. § 3374(c).

Expanded eligibility for tax-related deadline extensions (sec. 104).

Under IRC § 7508(a), individuals serving in a Presidentially-declared combat zone are allowed extra time to complete a variety of tax-related activities, including filing returns and paying taxes. The Act expands the group of taxpayers eligible for the extensions to individuals serving in a contingency operation as determined under 10 U.S.C. § 101(a)(13). Examples of contingency operations include operations where members of the Armed Forces are or may become involved in hostilities against a foreign enemy and operations during national emergencies that require the call up of members of the Armed Forces. The new rule applies for any period for performing an act that did not expire before November 11, 2003.

Expanded eligibility for tax-exempt status for military organizations (sec. 105). Under IRC § 501, military organizations may qualify for tax-exempt status if (1) at least 75% of the members are past or present members of the Armed Forces and (2) substantially all of the other members are cadets or spouses, widows, or widowers of past or present members of the Armed Forces or of cadets. The Act eases the "substantially all" requirement by allowing ancestors or lineal descendants of past or present members of the Armed Forces or of cadets to be included. The change applies to taxable years after November 11, 2003.

² IRC § 6511.

³ The provision for the death gratuity payment is found in 10 U.S.C. § 1478(a).

Clarification of treatment of dependent care assistance programs (sec. 106). The tax treatment of payments made to members of the Armed Forces under dependent care assistance programs has been unclear. The Act amends IRC § 134 to make it clear that these payments are subject to exclusion as a qualified military benefit. Thus, if a payment meets the qualifications in section 134, it may be excluded from income. The change applies for taxable years after December 31, 2002.

Tax favored status for distributions to military academy attendees from education savings accounts (sec. 107). Under IRC § 530(d), a portion of a distribution made from a Coverdell education savings account that exceeds the taxpayer's educational expenses is included in gross income and penalized by an additional tax. The Act exempts distributions made to attendees of military academies from the additional tax. The exemption is limited to the attendee's "advanced education costs" that are described in 10 U.S.C. § 2005(e)(3). The change applies for taxable years after December 31, 2002.

Deduction for overnight travel expenses of National Guard and Reserve members (sec. 109). Prior to the Act, overnight travel expenses of National Guard and Reserve members were deductible only by taxpayers who itemized their deductions, subject to the limitation on miscellaneous itemized deductions. The Act creates an above-the-line deduction for these expenses. The expenses are limited to the general Federal per diem rate and must be incurred while the reservist is serving more than 100 miles from home.⁴ The change applies to expenses paid or incurred after December 31, 2002.

Other Measures

Suspension of tax-exempt status for terrorist organizations (sec. 108). The Act suspends the tax-exempt status or the application for such status for any organization that is either (1) designated a terrorist organization by executive order or under authority found in the Immigration and Nationality Act, the International Emergency Economic Powers Act, or the United Nations Participation Act or (2) designated by executive order as supporting terrorism or engaging in terrorist activity. No deduction is allowed for any contribution to the organization during the suspension. The suspension lasts until the designation is rescinded under the authority by which it was made. No challenges to the suspension, designation, or denial of a deduction are allowed in any proceeding concerning the tax liability of the organization or another taxpayer. The new rules apply to all designations, whether made before, on or after November 11, 2003.

Tax relief for astronauts killed in the line of duty (sec. 110). The Act provides tax relief to astronauts who die in the line of duty after December 31, 2002.⁵ First, astronauts are not subject to the income tax in the year of death and in earlier years

⁴ While the Act is silent on this matter, it would appear that reservists could continue to deduct overnight travel expenses as an itemized deduction without being subject to these two limitations. The ability to deduct the expenses would then be subject to the limitation on miscellaneous itemized deductions.

⁵ The relief is generally similar to that provided to specified victims of terrorism in the Victims of Terrorism Tax Relief Act of 2001, P.L. 107-134.

beginning with the taxable year prior to that in which the mortal injury occurred.⁶ If the tax liability for those years, disregarding the exemption, is less than \$10,000, then the taxpayer is treated as having made a tax payment in the final taxable year that is equal to \$10,000 less the liability. Further, the Act excludes employee death benefit payments from the astronaut's income⁷ and applies reduced estate tax rates to the astronaut's estate.⁸

Extension of customs user fees (sec. 201). The authorization for the customs user fees found in 19 U.S.C. § 58c(j)(3) is extended from March 31, 2004 to March 1, 2005.

⁶ IRC § 692.

⁷ IRC § 101(i).

⁸ IRC § 2201.