

Essential tax insights for military families

Military service members and their families face unique challenges, from frequent moves to overseas deployments. Fortunately, the federal tax code includes a range of benefits, deductions, and special rules designed to ease their financial burden. For federal tax purposes, the U.S. Armed Forces includes officers and enlisted personnel in all regular and reserve units controlled by the Secretaries of Defense, the Army, Navy, Marine Corps, Air Force, Space Force and the Coast Guard. However, veterans, retirees, U.S. Merchant Marines and American Red Cross employees and volunteers are not eligible.

Income earned from a combat zone

The combat zone exclusion is one of the service members' most significant tax benefits. Enlisted personnel, warrant officers, and commissioned officers can exclude pay earned in a combat zone from gross income. Service members can review their Leave and Earnings Statement (LES) to determine if they have eligible pay. Highlights of the exclusion include the following points:

- Commissioned officers (non-warrant officers) can exclude up to the highest enlisted pay plus hostile fire/imminent danger pay for each month served in a combat zone.
- Tax-free pay includes basic pay, re-enlistment bonuses, hostile fire/imminent danger pay and accrued leave earned in combat zones.
- Non-taxable income still counts toward IRA contribution eligibility and certain tax credits, such as the earned income tax credit (EIC).

Extra time to file and pay any tax liability

Service members deployed to a combat zone or a qualified hazardous duty area will automatically receive additional time to file returns and pay taxes. Suppose the military member lives in the U.S.. In that case, they can receive an automatic six-month extension to file their return by filing Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*.

If the service member lives outside of the U.S., they may qualify for an automatic two-month extension without filing Form 4868, and an additional four-month extension by filing Form 4868 by June 15 of that tax year. Although the service member does not have to send in a payment of any tax due with the extension, interest will be due on any late payments.

Combat injury extensions and decedent provisions

Suppose a service member is hospitalized due to combat zone injuries. In that case, the filing extension period continues for up to 180 days after discharge from the hospital, even if the hospital is outside the combat zone. Additionally, certain disability severance payments are excluded from income if related to combat injuries.

In addition, the federal government can waive a servicemember's tax liability for the year that the servicemember died (sometimes liabilities from previous years, too). Tax refunds can also be issued if the servicemember died during active service in a combat zone from wounds, disease or other injury, or from wounds or injury incurred in a terrorist or military action.

Moving expenses may be deducted

Military members who move due to a permanent change of station (PCS) can deduct certain unreimbursed moving expenses. Eligible expenses might include transportation, household goods storage and personal effects. Travel expenses (including lodging, but not meals) for the service member and family members from the old home to the new one are eligible.

Special rules for military homeowners

Military families move often, making it challenging to meet the tax code's standard ownership and use tests for excluding up to \$250,000 (\$500,000 married filing jointly) of gain on the sale of a primary home. Taxpayers must have lived in the home as a primary place of residence for 2 of the last 5 years. For many military families, staying in one place for that length of time can be difficult. However, servicemembers have a special rule: Active-duty service suspends the clock for ownership and use up to 10 years, calculated from when the servicemember or their spouse is on qualified military orders to the date of sale. Servicemembers must be on a qualified extended assignment more than 50 miles from their primary residence to keep up to \$250,000 (\$500,000 MFJ) exempt from tax.

Travel deduction for reservists

Reservists who travel more than 100 miles from home to perform reserve duties may deduct unreimbursed travel expenses as an adjustment to income, even if they don't itemize. Mileage, tolls, parking, lodging and 50% of their meals are deductible on Schedule 1 (Form 1040). Reservists can include overnight travel expenses for active-duty requirements.

Earned income and child tax credits

Because combat pay is tax-exempt, servicemembers might worry they can't claim tax credits tied to the earned income they made during the year. However, in this case, combat pay is considered earned income for the earned income tax credit (EITC). Military families may also be eligible for the following credits:

- Child tax credit (CTC) and the additional child tax credit (ACTC)

- Child and dependent care credit is worth up to 35% of qualifying childcare expenses for children under age 13. Families are eligible for this credit if both spouses work or one spouse is a full-time student or disabled.

Residency rules for military families

The *Military Spouses Residency Relief Act* (MSRRA) allows military spouses to retain their state of legal residence for tax purposes even if they move with the service member under military orders.

Key points:

- Service members do not change domicile solely because they move under military orders.
- Spouses may elect to use the same state of legal residence as the service member for tax purposes.

This can reduce or eliminate state income tax obligations when stationed in a state with income tax if the legal residence is in a tax-free state.

