

**MSP  
#13****MILITARY ASSISTANCE: The IRS's Customer Service and Information Provided to Military Taxpayers Falls Short of Meeting Their Needs and Preferences****RESPONSIBLE OFFICIAL**

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**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

There are about 1.3 million active duty service members, and over 800,000 Reserves and National Guard personnel in the United States.<sup>2</sup> Those in uniform have undergone repeated deployments to war zones and many have endured extreme, and often invisible, psychological pain.<sup>3</sup> Whether stationed domestically or overseas, or serving on active duty or reserve duty, service members encounter questions about how to apply statutory extensions when returning from combat deployments, how the capital gain exclusion applies to them when selling their homes, whether to include nontaxable combat pay in earned income for purposes of the Earned Income Tax Credit (EITC), and whether they can make early Individual Retirement Account (IRA) withdrawals without incurring penalties. Their tax challenges are compounded if they must face the IRS alone in resolving post-filing tax disputes.

The demanding situations of military personnel, in addition to the unique issues they face, call for dedicated taxpayer service and information that meets the needs and preferences of these taxpayers. Yet, the IRS does not have employees assigned solely to assist service members. The IRS's service to this taxpayer population instead is generally limited to posting information on the web, and providing tax software and training to military partners who prepare tax returns at military installations around the

- 1 See Taxpayer Bill of Rights (TBOR), <http://www.TaxpayerAdvocate.IRS.gov/taxpayer-rights>. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2017 Conference Report, Pub. L. No. 114-840, § 401. The NDAA is an annual bill that sets policies and budgets for the U.S. Department of Defense (DoD). DoD, *About the Department of Defense (DoD)*, <https://www.defense.gov/About/> (last visited Dec. 18, 2017).
- 3 Some veterans may suffer from mental disorders, such as Post-Traumatic Stress Disorder (PTSD). See *National Institute of Mental Health, Post-Traumatic Stress Disorder*, <https://www.nimh.nih.gov/health/topics/post-traumatic-stress-disorder-ptsd/index.shtml> (Feb. 2016). See also National Taxpayer Advocate 2009 Annual Report to Congress 351-56 (Legislative Recommendation: *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income*).

world.<sup>4</sup> However, much of the IRS's information about military tax issues is inadequate,<sup>5</sup> obsolete,<sup>6</sup> or just plain wrong.<sup>7</sup>

The National Taxpayer Advocate has identified the following issues pertaining to the IRS customer service for military taxpayers:

- IRS online information and publications for the military is insufficient and outdated;
- Complex military tax issues warrant a special unit of Stakeholder Partnership, Education and Communication (SPEC) staffed with veterans whose responsibilities are to develop and conduct outreach, education, and assistance to current military taxpayers and the organizations that provide tax assistance to these taxpayers;
- SPEC lacks funding that would enable them to travel to overseas military locations to provide face-to-face training to military Volunteer Income Tax Assistance (VITA) volunteers; and
- A dedicated toll-free telephone line for service members and their families, both in and out of tax season, is essential for this population.

4 See, e.g., Internal Revenue Manual (IRM) 22.30.1.8.7.1.5.2, *Military* (Sept. 26, 2016). For example, military Volunteer Income Tax Assistance (VITA) volunteers Army-wide prepared over 108,000 tax returns on average from calendar years (CY) 2013 to 2016. During fiscal year 2017, they prepared 87,806 federal tax returns, including approximately 13,000 that were prepared at overseas locations. Army's Client Information System (CIS), Sep. 9, 2017; CIS, Dec. 9, 2017; CIS, Dec. 11, 2017. The numbers of military tax returns are all input into the Army's CIS by the Officers in Charge of the individual tax centers world-wide and maintained by the U.S. Army Legal Assistance Policy Division in Washington, D.C.

5 For example, service members may invest as much as \$54,000 in an Individual Retirement Account (IRA) when serving in a combat zone; however, this information is missing from the IRS website. See IRS, *Tax Information for Members of the Military*, <https://www.irs.gov/individuals/military> (last visited Dec. 18, 2017). Additionally, nowhere on [irs.gov](https://www.irs.gov) can a veteran find information on the Combat-Injured Veteran Tax Fairness Act of 2016. This legislation provides veterans additional time to claim a refund if they had taxes improperly withheld from their severance pay.

6 For example, the *Miscellaneous Provisions — Combat Zone Service* link on [irs.gov](https://www.irs.gov) indicates it was last reviewed in August 2017; however, only the IRA contribution for 2006 is provided: "[t]he IRA contribution limit for 2006 is \$4,000 for those under age 50 and \$5,000 for those 50 and over." See IRS, *Miscellaneous Provisions — Combat Zone Service*, <https://www.irs.gov/newsroom/miscellaneous-provisions-combat-zone-service> (last visited Dec. 19, 2017).

7 For example, [irs.gov](https://www.irs.gov) reports the death gratuity paid to survivors of deceased service members is \$12,000 for deaths occurring after Sep. 10, 2001. The death gratuity program actually provides for a tax-free payment of \$100,000 to eligible survivors of members of the Armed Forces who die while on active duty or while serving in certain reserve statuses. See IRS, *Highlights: Military Family Tax Relief Act*, <https://www.irs.gov/newsroom/highlights-military-family-tax-relief-act> (last visited Dec. 19, 2017). The death gratuity has been at the \$100,000 level since 2006. See NDAA for Fiscal Year 2006, Pub. L. No. 109-163, § 664 (2006).

## ANALYSIS OF PROBLEM

### Background

#### *The Number of Military Taxpayers Is Now Increasing*

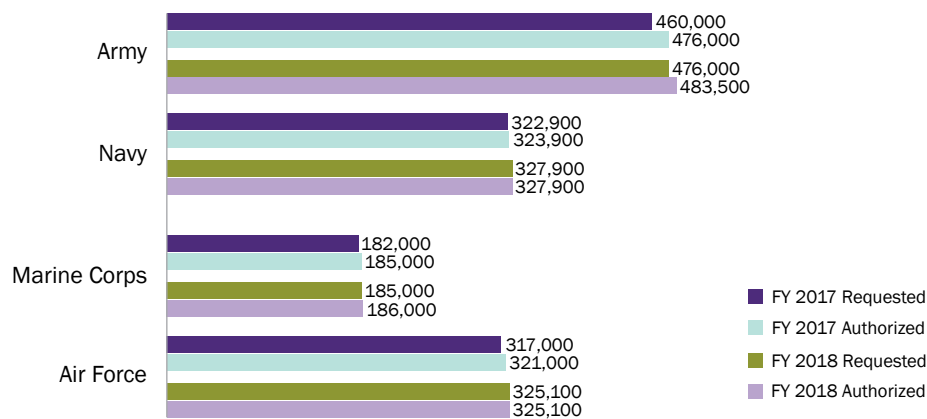
Over the past 50 years, the size of the military has shrunk to about 1,338,000 active duty service members,<sup>8</sup> an 85 percent decrease from the 8,744,000 service members during the Vietnam War.<sup>9</sup> As those numbers have fallen, the connections between military personnel and the civilian population appear to be growing more distant, prompting also a perception that the public does not understand the problems service members face.<sup>10</sup>

Although the size of the military has been cut significantly in recent years, that number is now increasing.<sup>11</sup> Active-duty end strengths<sup>12</sup> were required to increase by 24,000 service members by September 30, 2017.<sup>13</sup> The Army succeeded in meeting its 2017 recruiting and retention goals across the active Army and National Guard,<sup>14</sup> as did the Air Force.<sup>15</sup> In FY 2018, the size of the military will increase by an additional, nearly 20,000 troops.<sup>16</sup>

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- 8 See Defense Manpower Data Center, *DoD Personnel, Workforce Reports & Publications, Military Personnel Current Strength*, [https://www.dmdc.osd.mil/appj/dwp/dwp\\_reports.jsp](https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp) (last visited Dec. 19, 2017).
  - 9 See Department of Veterans Affairs, *America's Wars Fact Sheet*, [https://www.va.gov/opa/publications/factsheets/fs\\_americas\\_wars.pdf](https://www.va.gov/opa/publications/factsheets/fs_americas_wars.pdf) (Apr. 2017).
  - 10 Pew Research Center Social and Demographics Trends, *The Military-Civilian Gap: Fewer Family Connections*, <http://www.pewsocialtrends.org/2011/11/23/the-military-civilian-gap-fewer-family-connections> (Nov. 23, 2011).
  - 11 See Defense Manpower Data Center, *DoD Personnel, Workforce Reports & Publications, Military Personnel Current Strength*, [https://www.dmdc.osd.mil/appj/dwp/dwp\\_reports.jsp](https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp) (last visited Dec. 19, 2017). From FY 2011 to FY 2016, U.S. military personnel decreased nine percent from 1,424,317 to 1,301,308. Congress began decreasing the size of the military in anticipation of the withdrawal of U.S. forces from Iraq in 2011, the drawdown of U.S. forces in Afghanistan which began in 2012, and budgetary constraints. End-strengths for the Air Force and Navy have been generally declining since 2001. See Congressional Research Service (CRS), *FY2016 National Defense Authorization Act: Selected Military Personnel Issues* (Dec. 15, 2015). However, the military has now been mandated to increase in size. See National Defense Authorization Act for Fiscal Year 2018 Conference Report to Accompany H.R. 2810, § 401, at 193-194.
  - 12 The term “end-strength” refers to the authorized strength of a specified branch of the military at the end of a given fiscal year, while the term authorized strength means “the largest number of members authorized to be in an armed force, a component, a branch, a grade, or any other category of the armed forces.” 10 United States Code (U.S.C.) § 101(b)(11).
  - 13 See National Defense Authorization Act for Fiscal Year 2018 Conference Report to Accompany S. 1519, § 401, at 125.
  - 14 See Defense News, *Personnel chief: The Army is preparing to grow the force by 17,000 soldiers in 2018*, <https://www.defensenews.com/news/your-army/2017/10/08/personnel-chief-the-army-is-preparing-to-grow-the-force-by-17000-soldiers-in-2018/> (Oct. 8, 2017).
  - 15 See Air Force Times, *Air Force Hits Recruiting Goals With 33,000 New Airmen*, <https://www.airforcetimes.com/news/your-air-force/2017/10/15/air-force-hits-recruiting-goals-with-33000-new-airmen/> (Oct. 15, 2017).
  - 16 See National Defense Authorization Act for Fiscal Year 2018 Pub. L. No. 115-91, § 401. Authorized end strengths for active duty military personnel by September 30, 2018 is 483,500 for the Army, 327,900 for the Navy, 186,000 for the Marine Corps, and 325,100 for the Air Force. The Army will grow by at least 7,500, the Navy by nearly 4,000, the Marine Corps by 1,000, and the Air Force by about 4,100. Reserve forces will grow by about 3,400.

FIGURE 1.13.1<sup>17</sup>

## Active-Duty Military Personnel, FYs 2017-2018



Reserves and National Guard personnel numbers are set to increase as well by the end of FY 2018.<sup>18</sup>

### *Tax Issues Unique to the Military Are Complex*

Tax issues pertaining to the military add a layer of complexity to a tax system that has grown more complex by the year.<sup>19</sup> These issues, discussed more thoroughly below, include extensions of tax filing deadlines, especially for those serving overseas; combat zone income exclusions; tax abatement for service members who die in combat zones or qualified hazardous duty areas; IRA contributions from tax-free combat pay; tax return signature authority without a power of attorney; unique capital gains exclusions for service members who sell their homes; deductions for relocation expenses, travel expenses for reservists, and military uniforms; waivers for early withdrawals from IRAs; rules pertaining to the choice of service members to include their nontaxable combat pay as earned income for purposes of EITC; and refund claims under the Combat-Veterans Tax Fairness Act of 2016.

<sup>17</sup> The annual federal budget process begins with a detailed proposal from the President that is developed through an interactive process between agencies and the President's Office of Management and Budget (OMB). The President's budget request is simply a proposal by the administration of its fiscal goals and policy preferences. See *Center on Budget and Policy Priorities, Policy Basics: Introduction to the Federal Budget Process*, <https://www.cbpp.org/research/policy-basics-introduction-to-the-federal-budget-process> (Aug. 23, 2017). This request has no binding authority on Congress. See also National Defense Authorization Act for Fiscal Year 2018 Report to Accompany S. 1519, § 401.

<sup>18</sup> See National Defense Authorization Act for Fiscal Year 2017, Pub. L. No. 114-328, § 411; see also National Defense Authorization Act for Fiscal Year 2018 Conference Report to Accompany H.R. 2810, § 411, at 193-194.

<sup>19</sup> For a detailed discussion on the efforts by the National Taxpayer Advocate in urging Congress to simplify the tax code, see National Taxpayer Advocate 2016 Annual Report to Congress 305-324 (Legislative Recommendation: *Tax Reform: Simplify the Internal Revenue Code Now*).

**EXTENSION OF TAX RETURN FILING DEADLINES.** Service members who serve in a combat zone<sup>20</sup> or qualified hazardous duty area<sup>21</sup> are allowed additional time to take care of tax matters.<sup>22</sup> This extension applies to the deadline for filing an annual tax return, paying any tax due, and filing a claim for a refund.<sup>23</sup> Additionally, service personnel are not charged interest or penalties attributable to the delayed deadline.<sup>24</sup> The deadline is extended for at least 180 days after the latter of the last day the taxpayer is in a combat zone or qualified hazardous duty area, or the last day of any continuous qualified hospitalization for wounds, disease, or injury sustained while serving in the combat zone.<sup>25</sup> In addition to the 180 days, the deadline is extended by the number of days that were left for the service member to file when he or she entered a combat zone.<sup>26</sup> For example, if a service member enters a combat zone on April 5, ten days before the tax filing deadline of April 15, the service member had ten days remaining to file a tax return. These ten days are then added to his or her 180-day extension, affording the service member 190 days after leaving the combat zone to file his or her tax return.

Additionally, whether in or outside of a combat zone or qualified hazardous duty area, if a service member's ability to pay an income tax liability is materially affected by his or her military service, payment of tax is deferred up to 180 days after termination of service, without any accrual of interest or penalties for that period.<sup>27</sup> This rule is broader than the extension under Internal Revenue Code (IRC) § 7508, in that it applies to all service members, whether deployed in a combat zone or not. The statute of limitations against the collection of tax deferred under this section is suspended for the period of military service of the service member and for an additional period of 270 days thereafter.<sup>28</sup> To receive this deferment, the service member must make a written request that is supported by evidence that his ability to pay is materially affected by his military service.

**EXTENSION TO FILE FOR SERVICE MEMBERS OVERSEAS.** Service members stationed abroad at the time of the filing due date automatically get two more months, until June 15, to file their returns.<sup>29</sup> If service members still need the additional four months, until October 15, to file, overseas service members must submit Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*, by June 15.

20 See IRC § 112(c)(2). The term "combat zone" means any area which the President of the United States by Executive Order designates, for purposes of this section or corresponding provisions of prior income tax laws, as an area in which Armed Forces of the United States are or have engaged in combat.

21 A Qualified Hazardous Duty Area (QHDA) is treated in the same manner as if it were a combat zone. See DoD Financial Management Regulation, DoD 7000.14-R ¶ 440203 (July 2016). "NOTE: In order to have [combat zone tax exclusion] treatment of wages for services performed in a QHDA, a member must be entitled to hostile fire or imminent danger pay while performing service in the QHDA." *Id.*

22 See IRC § 7508(a).

23 The extension also applies to filing a petition with the Tax Court for redetermination of a deficiency, or for review of a decision rendered by the Tax Court; allowance of a credit or refund of any tax; bringing suit upon any such claim for credit or refund; assessment of any tax; giving or making any notice or demand for the payment of any tax; collection, by levy or otherwise; bringing suit by the United States, or any officer on its behalf, in respect of any liability in respect of any tax; and any other act required or permitted under the internal revenue laws specified by the Secretary. See IRC § 7508(a).

24 IRC § 7508(a); See also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).

25 *Id.*

26 *Id.*

27 50 U.S.C. § 4000 (a)-(b). While there is no definition in the Servicemembers Civil Relief Act (SCRA) of the term "materially affected," courts generally require that military duties prevent the member from appearing in court at the designated time and place or assisting in the preparation or presentation of a case, or substantially impair the member's ability to pay financial obligations. Thus, a court will determine whether a service member's ability to pay an income tax liability is materially affected by his military service on a case-by-case basis.

28 50 U.S.C. § 4000 (a), (c).

29 See Treas. Reg. § 1.6081-5(a)(6). Extensions are granted only to file forms, not to make payments.

**COMBAT ZONE INCOME EXCLUSION.** While a service member is serving in a combat zone as an enlisted member or as a warrant officer for any part of a month, all of his or her income for that month is exempt from federal taxes.<sup>30</sup> For officers, the monthly exclusion is capped at the highest rate of enlisted pay, plus any hostile fire or imminent danger pay received.<sup>31</sup> In some cases, service outside a combat zone can be considered service in a combat zone if the Department of Defense (DoD) designates it in direct support of military operations in the combat zone, or if the service qualifies for duty subject to hostile fire or imminent danger pay.<sup>32</sup> Geographic areas that are considered tax-qualified combat zones are listed on the IRS website. *However, this list is out-of-date.*<sup>33</sup>

**TAX ABATEMENT IN CASE OF DEATH.** A service member who dies in a combat zone or qualified hazardous duty area, or as a result of wounds, disease, or injury incurred while serving in the combat zone is exempt from income tax for the taxable year in which death occurs and any prior taxable year ending on or after the first day served in a combat zone or qualified hazardous duty area.<sup>34</sup> Because an amended return is a claim for refund, it is subject to the statutory period of limitations that applies to refunds.<sup>35</sup> However, service members who are deployed outside of the United States, away from their permanent duty stations, and are serving in support of a qualified hazardous duty area<sup>36</sup> are allowed an extension of time allowed for performing most acts required by the IRC.<sup>37</sup> Such an extension can hold a previous tax year open longer than three years.<sup>38</sup> Moreover, the service member's tax liability is forgiven for all income, not just military compensation.<sup>39</sup>

**IRA CONTRIBUTIONS FROM COMBAT PAY.** While combat pay is generally nontaxable, it is included in income for purposes of calculating the limits on contributions and deductions for an IRA.<sup>40</sup> The earnings on contributions will also be tax-free when withdrawn, assuming the service member

30 IRC § 112; Treas. Reg. § 1.112-1; see also, IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).

31 *Id.* See also DoD Financial Management Regulation, DoD 7000.14-R ¶ 440203 (July 2016).

32 See DoD Financial Management Regulation, DoD 7000.14-R ¶ 440203 (July 2016).

33 The DoD has certified Tajikistan, Kyrgyzstan, and Uzbekistan as "in direct support" of a military operation in a combat zone through May 31, 2014 only. The IRS website, <https://www.irs.gov/newsroom/combat-zones>, lists them as still receiving combat zone benefits. Additionally, Syria was designated by the Secretary of Defense as an "in direct support" area beginning Jan. 1, 2004. The IRS website does not list Syria at all. Lebanon's certification as an "in direct support" area is through February 11, 2020. The IRS website does not indicate that its certification is for a limited time. See DoD Financial Management Regulation, DoD 7000.14-R ¶ 440223 (July 2016).

34 IRC § 692(a)(2); see also Treas. Reg. § 1.692-1; Rev. Proc. 2004-26, 2004-19 I.R.B. 890. The word, "a" in the phrase, "in a combat zone" is significant. In short, a service member who has had multiple deployments to combat zones over the years and then dies in a combat zone, may have multiple years of taxes forgiven, depending on the amount of time the service member has spent outside of combat zones between deployments.

35 Under IRC § 6511(a), a taxpayer must file a claim for credit or refund of an overpayment within: 1) three years from the time the return was filed, or 2) two years from the time the tax was paid, whichever is later. If no return was ever filed by the taxpayer then the claim must be filed within two years of payment of the tax.

36 See DoD Financial Management Regulation, DoD 7000.14-R (July 2016).

37 IRC § 7508(a)(1)(E) provides service members serving in a combat zone an automatic extension to file a claim for refund for the period that the service member is in the combat zone, and for the next 180 days thereafter.

38 IRC § 7508(a); IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).

39 This may be important for a reservist service member or a service member with large investment income.

40 Heroes Earned Retirement Opportunities Act, Pub. L. No. 109-227, § 2 (2006).



qualifies.<sup>41</sup> Combat pay service also entitles service members to invest as much as \$54,000 in an IRA when serving in a combat zone.<sup>42</sup> This is important information missing from the IRS website.<sup>43</sup>

**RETURN SIGNATURE AUTHORITY.** Generally, joint returns must be signed by both spouses. However, if a service member is deployed to a combat zone, a power of attorney is not needed to sign the return on the deployed spouse's behalf.<sup>44</sup> The other spouse must attach to the return a signed statement explaining the combat zone status.<sup>45</sup> If a service member deployed to a combat zone is deemed missing in action, a joint return can be filed under the same rules for up to two years after the termination of the combat zone designation of the deployment location.<sup>46</sup> The joint return will be considered valid even if it is later determined that the missing spouse died before the year covered by the return.<sup>47</sup>

**CAPITAL GAINS EXCLUSION FOR SALE OF PRIMARY RESIDENCE.** Taxpayers, whether civilian or military, can generally avoid paying capital gains taxes on the sale of their home if they owned it and used it as their qualifying principal residence for two out of the five years preceding the sale, permitting homeowners to exclude up to \$250,000 in gains for individuals or \$500,000 for married couples.<sup>48</sup> Service members, however, can suspend the five-year test period for up to ten years when they are assigned to a duty station that is at least 50 miles from the house for a period of 90 days or more.<sup>49</sup>

**RELOCATION EXPENSES.** Service members are permitted to deduct the reasonable unreimbursed expenses of relocating themselves and their families, without having to meet the distance and time tests.<sup>50</sup>

**TRAVEL EXPENSES FOR RESERVISTS.** If service members are called more than 100 miles away from home to perform Reserve duties, they can generally deduct any unreimbursed travel expenses.<sup>51</sup>

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- 41 If a taxpayer is age 59½ or over, he may withdraw any amount from his Roth IRA as long as the account has been open for at least 5 years. If a taxpayer is under age 59½, he may withdraw the exact amount of his Roth IRA contributions with no penalties, although there are several exceptions that enable Roth IRA plan participants to withdraw funds from Roth IRAs that otherwise would be subjected to ordinary income taxes and the ten percent early withdrawal penalty. IRC § 408A(d)(2)(A)(i).
- 42 Deployed military members can exceed the \$18,500 annual Elective Deferral Limit. See IRC § 415(b)(2)(H); IRC § 415(c); See also IRM 4.72.7.3, *Annual Additions* (May 22, 2017); IRS Notice 2016-62, 2016-2 C.B. 725; and Thrift Savings Plan, *Contribution Limits*, <https://www.tsp.gov/PlanParticipation/EligibilityAndContributions/contributionLimits.html> (last visited Dec. 19, 2017). The annual addition limit for 2018 is set to increase to \$55,000. See IRS Notice 2017-64.
- 43 See IRS, <https://www.irs.gov/individuals/military> (last visited Dec. 19, 2017).
- 44 See Treas. Reg. §1.6012-1(a)(5).
- 45 *Id.* See also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016); Associate Chief Counsel (Procedure & Administration) Desk Guide, Chapter 1, *Filing Requirements*, <https://www.irs.gov/pub/irs-utl/PADeskbook.pdf> (last visited Dec. 6, 2017).
- 46 See IRC § 6013(f).
- 47 *Id.* See also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).
- 48 See IRC § 121(b)(2)(A); see also 2003 Military Family Tax Relief Act, Pub. L. No. 108–121, § 101 (2003).
- 49 See IRC § 121(d)(9). This period of suspension cannot last longer than 10 years and can be on only one property at a time. See also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).
- 50 See IRC § 217; see also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016). The Distance Test mandates that a taxpayer's new principal workplace must be at least 50 miles farther from his or her old home than his old workplace was. For example, if a taxpayer's old workplace was three miles from his or her old home, the taxpayer's new workplace must be at least 53 miles from that home. The Time Test mandates that a taxpayer must work full time in the general area of his new workplace for at least 39 weeks during the 12 months right after he or she moves.
- 51 See 2003 Military Family Tax Relief Act, Pub. L. No. 108–121, § 109 (2003); see also IRS Pub. 529, *Miscellaneous Deductions* (Dec. 2016). This deduction is an above-the-line deduction and is allowed whether or not the taxpayer elects to itemize.

**UNIFORM EXPENSES.** If service members are prohibited from wearing certain uniforms when off duty, they can generally deduct the cost to buy and maintain those uniforms if those expenses are in excess of two percent of their Adjusted Gross Income (AGI).<sup>52</sup>

**IRA EARLY WITHDRAWALS.** Because a call to active duty sometimes creates financial hardship for reservists whose military income is much lower than their civilian pay, early withdrawal penalties may be waived. If a service member takes money from his IRA, 401(k) or certain other retirement plans, the IRS may waive the ten percent penalty tax normally applied for withdrawals before age 59½.<sup>53</sup>

**EARNED INCOME.** A service member's nontaxable pay, such as combat pay, the Basic Allowance for Housing (BAH),<sup>54</sup> and the Basic Allowance for Subsistence (BAS),<sup>55</sup> is not included in the earned income for EITC purposes.<sup>56</sup> However, the military service member and spouse can each choose to have their nontaxable combat pay included in earned income for purposes of the EITC.<sup>57</sup> This scenario is usually seen during tax years in which the service member has a lengthy deployment in a combat zone, where his or her income is nontaxable. Including it as earned income may decrease the amount of tax the service member owes and may mean a larger refund, assuming he is still eligible for the EITC.

**SEVERANCE PAY FOR WOUNDED VETERANS.** The Combat-Injured Veterans Tax Fairness Act of 2016<sup>58</sup> gives veterans who retired from the military for medical reasons additional time to claim a refund if they had taxes improperly withheld from their severance pay. The DoD will identify veterans impacted by the law and send notices to them. These veterans will have the opportunity to file

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- 52 See IRC § 132(a)(3) and IRC § 162. An employee can exclude from gross income any fringe benefit which qualifies as a working condition fringe under IRC § 132(a)(3). A "working condition fringe" includes any property or services provided by an employer to an employee to the extent that, if the employee paid for such property or services, such payment would be allowed as a deduction under IRC § 162 as an ordinary trade or business expense. See also IRS Pub. 529, *Miscellaneous Deductions* (Dec. 2016). Generally, military taxpayers cannot deduct the cost of uniforms if they are on full-time active duty in the armed forces. However, a reservist can deduct the unreimbursed cost of his uniform if military regulations restrict him from wearing it except while on duty as a reservist. If local military rules do not allow a service member to wear his uniform when he is off duty, he can deduct the amount by which the cost of buying and keeping up these uniforms is more than the uniform allowance he receives.
- 53 See IRC § 72(t)(2)(G). See also National Taxpayer Advocate 2015 Annual Report to Congress 401-408 (Legislative Recommendation: *Hardship Withdrawals: Provide a Uniform Definition of a Hardship Withdrawal from Tax-Advantaged Retirement Arrangements*) (describing the complexities involved in tax-advantaged retirement plans and arrangements). There are several different definitions of "hardship," depending on the taxpayer's type of retirement plan or arrangement. The National Taxpayer Advocate has long-advocated for uniform rules regarding the definition of "hardship" and the tax consequences of hardship withdrawals from tax-advantaged plans. *Id.*
- 54 The Basic Allowance for Housing (BAH) is a U.S. based allowance prescribed by geographic duty location, pay grade, and dependency status. It provides uniformed service members equitable housing compensation based on housing costs in local civilian housing markets within the United States when government quarters are not provided. See Defense Travel Management Office, *Basic Allowance for Housing (BAH)*, <http://www.defensetravel.dod.mil/site/bah.cfm> (last visited Dec. 19, 2017).
- 55 Basic Allowance for Subsistence (BAS) is a monthly allowance meant to offset costs for a service member's meals. All enlisted members get full BAS, but pay for their meals, including those provided by the government. BAS is linked to the price of food. Each year it is adjusted to account for the increase in food prices, as measured by the USDA food cost index. This is why the increase to BAS will not necessarily be the same percentage as that applied to the increase in the pay table, as annual pay raises are linked to the increase of private sector wages. See Military Pay and Benefits, *Basic Allowance for Subsistence (BAS)*, <http://militarypay.defense.gov/Pay/Allowances/BAS.aspx> (last visited Dec. 19, 2017).
- 56 See IRC § 32. The Earned Income Tax Credit (EITC) is an anti-poverty program consisting of a refundable tax credit available to certain low income working taxpayers and their families.
- 57 The Working Families Tax Relief Act of 2004 gave taxpayers the option to include combat pay in EITC earned income. The Heroes Earnings Assistance and Relief Tax Act of 2008 made this change permanent. See Working Families Tax Relief Act of 2004, Pub. L. No. 108-311, § 104; Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, § 102.
- 58 Combat-Injured Veterans Tax Fairness Act of 2016, Pub. L. No. 114-292, 130 Stat. 1500 (2016).



amended returns dating back to 1991 to recover amounts that were withheld.<sup>59</sup> The IRS's website has no information about this significant provision, even on the Disabled Veterans link, in spite of the IRS's review of the web page as recently as November 27, 2017.<sup>60</sup>

### *IRS Service to the Military Taxpayers Largely Relies on the irs.gov web pages and the VITA Program*

The IRS does not have SPEC employees assigned solely to assist service members.<sup>61</sup> Similarly, very few military tax experts outside the IRS are available to assist the tens of thousands of active and reserve military taxpayers with preparing returns and other tax issues.<sup>62</sup> Additionally, there are no dedicated telephone lines for service members to call the IRS with questions. Instead, the IRS disseminates important tax information to service members via its website, using a broad brush.<sup>63</sup>

The IRS primarily relies on VITA volunteers to help with tax return preparation at military installations worldwide.<sup>64</sup> During FY 2017, military VITA volunteers Army-wide prepared 87,806 federal tax returns, and averaged over 108,000 tax returns from calendar years (CY) 2013 to 2016.<sup>65</sup> Of the returns prepared at Army installations during CY 2017, over 13,000 were prepared at overseas locations.<sup>66</sup>

The challenging situations of military personnel, in addition to the unique issues they face, call for a proactive approach to assisting this taxpayer population, as well as IRS employees who understand their needs.

### *IRS Online Information and Publications for the Military Are Insufficient and Outdated*

The irs.gov website appears to have a relatively comprehensive page for military service members, grouping its information in categories: current military personnel, those serving in a combat zone, former military personnel, and disabled veterans.<sup>67</sup> The page includes numerous links within each category to the Armed Forces Tax Guide;<sup>68</sup> particular legislation affecting service members, such as

59 Combat-Injured Veterans Tax Fairness Act of 2016, Pub. L. No. 114-292, 130 Stat. 1500 (2016).

60 See IRS, *Special Tax Considerations for Veterans*, <https://www.irs.gov/individuals/military/special-tax-considerations-for-veterans> (last visited Dec. 18, 2017).

61 The primary intermediary for IRS outreach to military personnel and their families is the Armed Forces Tax Council, which has a representative from each of the five military branches — Army, Air Force, Navy, Marines, and Coast Guard. See Internal Revenue Manual (IRM) 22.30.1.3.1.1, *Volunteer Income Tax Assistance (VITA)* (Jan. 10, 2013).

62 Currently, two active duty Army Judge Advocates world-wide possess Army-funded Tax LL.M.s (Master of Laws). The Army Judge Advocate General's Corps generally selects one Judge Advocate every two - four years to obtain a Tax LL.M. at Army expense. Attorneys from other service branches (Marines, Air Force, and Navy) may attend a week-long military income tax course each year prior to the tax season to prepare them to administer their military VITA programs. Email communication to TAS from Chief, Career Management Branch, Personnel, Plans & Training Office, Office of the Judge Advocate General, United States Army (Sept. 28, 2017) (on file with TAS).

63 See IRS, *Tax Information for Members of the Military*, <https://www.irs.gov/individuals/military> (last visited Dec. 19, 2017).

64 Commanders temporarily assign service members to prepare returns during tax season and provide space and equipment for tax centers. The IRS supports these efforts by providing tax software and training service members to address military specific tax issues.

65 See Army's CIS, Dec. 9, 2017. The numbers of military tax returns are all input into the Army's CIS by the Officers in Charge of the individual tax centers world-wide and maintained by the U.S. Army Legal Assistance Policy Division in Washington, D.C.

66 See Army's CIS, Dec. 9, 2017.

67 See, *Tax Information for Members of the Military*, <https://www.irs.gov/individuals/military> (last visited Dec. 19, 2017).

68 IRS Publication 3, *Armed Forces Tax Guide* (2016).

tax provisions provided in the Military Family Tax Relief Act of 2003;<sup>69</sup> filing topics with additional links to publications, form instructions, and other specific guidance; information about the military tax exclusion;<sup>70</sup> special tax considerations for disabled veterans; information for retirees, such as veterans education benefits,<sup>71</sup> taxable versus nontaxable income;<sup>72</sup> and Frequently Asked Questions (FAQs) about the Uniformed Services and Reemployment Rights Act (USERRA) and the “Veterans and Sailors Civil Relief Act of 1940 (SSCRA).”<sup>73</sup>

Notably, however, the reference to the SSCRA on the *irs.gov* website is significantly out of date, and the reference to the “Veterans and Sailors Civil Relief Act” is wrong.<sup>74</sup> The Act does not contain the word *Veterans*.<sup>75</sup> The Servicemembers Civil Relief Act (SCRA), was enacted over 14 years ago, on December 19, 2003, in response to the increased use of Reserve and National Guard military units in the Global War on Terrorism, and as a modernization and restatement of the protections contained in the SSCRA.<sup>76</sup> Additionally, this well-established legislation concerns individuals currently in the military, called to active duty from the Reserves or National Guard, or deployed service members, as opposed to veterans who have previously served.<sup>77</sup> Not only does the legislation not pertain to veterans, but its title does not and never did have the word “Veterans” in it.

The IRS’s website further reports, “The death gratuity paid to survivors of deceased Armed Forces members rises to \$12,000 and is not taxable (was \$6,000, with \$3,000 tax-free) ... for deaths occurring after 9/10/2001.”<sup>78</sup> The \$12,000 figure is grossly out-of-date. The death gratuity program actually provides for a tax-free payment of \$100,000 to eligible survivors of members of the Armed Forces who

69 Among the provisions of the Military Family Tax Relief Act of 2003 are tax provisions related to the following: death benefits; sale of principal residence; deduction for overnight travel expenses of National Guard and Reserve members; Department of Defense Homeowners Assistance Program; combat zone extensions expanded to contingency operations; dependent care assistance programs; and Military Academy attendees. See 2003 Military Family Tax Relief Act, Pub. L. No. 108-121 (2003).

70 A service member serving in a combat zone may exclude the following income: basic pay, reenlistment bonuses, school loan repayments associated with the months in a combat zone, Imminent Danger/Hostile Fire Pay, discharge benefits (i.e., selling accrued leave earned while in a combat zone), and awards and other financial incentives. See DoD Financial Management Regulation, DOD 7000.14-R (July 2016).

71 See U.S. Department of Education, *Information for Military Families and Veterans*, <https://www.ed.gov/veterans-and-military-families/information>, for information about educational benefits for service members. Payments for education, training, or subsistence under any law administered by the Department of Veterans Affairs (VA) are tax free. See also IRS Publication 970, *Tax Benefits for Education* (2016).

72 See IRS Publication 525, *Taxable and Nontaxable Income* (2016).

73 Recognizing the special burdens that members of the military may encounter trying to meet their financial obligations while on active duty, Congress passed the Soldiers’ and Sailors’ Civil Relief Act (SSCRA) in 1940. The SCRA was signed into law in 2003, replacing the SSCRA, and is codified at 50 U.S.C. App. 501 *et seq.*

74 See IRS, *Retirement Plans FAQs*, <https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-userra-and-sscr> (last visited Dec. 19, 2017).

75 *C.f.*, Pub.L. 111-275, the Veterans’ Benefits Act of 2010, which makes certain improvements to the SCRA.

76 See H. Rep. 108-81, at 32 (Apr. 30, 2003). See also S. Rept. 108-197, at 9 (Nov. 17, 2003) (stating that the military had activated approximately 300,000 Reserves since September 2001, and that a DOD survey indicated that the self-employed Reservists reported an average \$6,500 in lost income when mobilized or deployed).

77 The SCRA provides a wide range of protections to enable service members to devote their full attention to duty. A few examples of obligations they may be protected against are outstanding credit card debt; mortgage payments; pending trials; taxes; and terminations of leases.

78 See IRS, *Highlights: Military Family Tax Relief Act*, <https://www.irs.gov/newsroom/highlights-military-family-tax-relief-act> (last visited Dec. 19, 2017).

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Very few military tax experts outside the IRS are available to assist the tens of thousands of active and reserve military taxpayers with preparing returns and other tax issues. Additionally, there are no dedicated telephone lines for service members to call the IRS with questions. Instead, the IRS disseminates important tax information to service members via its website, using a broad brush.

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die while on active duty or while serving in certain reserve statuses.<sup>79</sup> The “Miscellaneous Provisions — Combat Zone Service” link on [irs.gov](https://www.irs.gov) was last updated in 2007.<sup>80</sup> The military information contained on [irs.gov](https://www.irs.gov) requires a thorough review and update on a regular basis.

The [irs.gov](https://www.irs.gov) website contains a portal with video and audio presentations on topics of interest to small businesses, individuals and tax professionals, but does not have any presentations on military tax issues. By including specific videos on the various military-specific tax issues, the IRS would be providing another avenue to reach service members around the world.

IRS Publication 3, *Armed Forces Tax Guide*,<sup>81</sup> covers the special tax situations of active members of the U.S. Armed Forces, although it does not cover military pensions or veterans’ benefits, nor does it provide the basic tax rules that apply to all military taxpayers. The IRS could do more by providing easy-to-read information papers explaining the many complex issues facing service members.

### **SPEC Lacks Funding That Would Enable Them to Travel to Overseas Military Locations to Provide Face-to-Face Training for Military VITA Volunteers**

Most large military installations around the world offer service members and their families free income tax filing assistance through the VITA program, managed by SPEC — the outreach and education office of the IRS’s Wage and Investment Division.<sup>82</sup> As stated above, service members have limited options for obtaining assistance with tax filing and rely primarily on military VITA sites where they can speak with a tax preparer knowledgeable about complicated military-specific tax issues in person.<sup>83</sup>

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79 Public Law 109-163 permanently increased the death gratuity from \$12,420 to \$100,000 for all active duty deaths resulting from wounds, injuries, or illnesses that are incurred in the line of duty, not just those occurring in combat-related situations, and was retroactive to September 10, 2001. See NDAA for Fiscal Year 2006, Pub. L. No. 109-163, § 664 (2006). The entire \$100,000 is tax free. See IRC § 134(b)(3)(C). For deaths occurring between October 7, 2001 and January 6, 2006, the law allows the DoD to make retroactive payments of the difference between the original death gratuity survivors received and the new \$100,000 amount. NDAA for FY 2006, Pub. L. No. 109-163, § 664 (2006). An additional death benefit may be possible depending on the circumstances and date of death. See 10 U.S.C. § 1478(d).

80 See IRS, *Miscellaneous Provisions — Combat Zone Service*, <https://www.irs.gov/newsroom/miscellaneous-provisions-combat-zone-service> (last visited Dec. 19, 2017). Shamefully, the most recent information on the page regarding IRA contribution limits is for 2006. The military web page indicates it was reviewed or updated as recently as August 17, 2017, albeit displaying wrong and outdated information.

81 IRS Publication, *Armed Forces’ Tax Guide* (2016).

82 See IRM 22.30.1.1, *What is Stakeholder Partnerships, Education and Communication* (Oct. 1, 2013). See also, IRS, *Free Tax Help Available for the Military*, <https://www.irs.gov/newsroom/free-tax-help-available-for-the-military> (Mar. 23, 2017).

83 Other tax filing options include Military OneSource, a DoD-funded program providing free online tax preparation and tax consultations for military families. Service members from all branches are eligible except for active duty Coast Guard personnel. Service members can file up to three state returns for each federal return and the link to the software is available six months past the April tax deadline — two advantages that Military OneSource has over the VITA program.

In the past, SPEC personnel with knowledge of military tax issues trained volunteers stationed at military bases abroad by using the Link and Learn course for the military certification. However, more and more the IRS is turning to the virtual classroom to train these volunteers.<sup>84</sup> Desperate for in-person training, some overseas installations must procure the expertise of a tax-trained attorney<sup>85</sup> who happens to be stationed in the country or a U.S.-based attorney<sup>86</sup> who travels to the other country to teach tax law. Given that there are only a handful of U.S. military lawyers who are tax law trained,<sup>87</sup> it is simply not feasible to rely on the model of having uniformed lawyers, who happen to be stationed at an overseas installation, provide VITA training.<sup>88</sup>

Overseas military VITA sites need dedicated IRS employees who are trained on the complex issues that service members face year after year. In addition, the IRS should strongly consider hiring veterans who are specifically charged with outreach, education, and training for military taxpayers and the organizations that support them. By providing the necessary training and focusing efforts on outreach, the IRS will be providing essential services to this taxpaying population and honor important taxpayer *rights to be informed, to quality service, to pay no more than the correct amount of tax, and to fair and just tax system.*

### Complex Military Tax Issues Warrant a Dedicated IRS Toll-Free Telephone Line for Service Members and Their Families, Both In and Out of Tax Season

Military OneSource is a DoD-funded program that provides service members and their families free or reduced cost tax filing.<sup>89</sup> In FY 2016, service members and their families filed more than 200,000 federal and state tax returns through Military OneSource.<sup>90</sup> Additionally, Military OneSource tax consultants conducted over 17,000 telephonic tax counseling sessions.<sup>91</sup> One of the most helpful aspects of the program is specialized phone support available to all service members. Consultants are available

84 For the first time in many years, SPEC will not be traveling to South Korea to deliver VITA training for the 2018 tax filing season, citing personal safety concerns for their employees. See email communication to TAS from SPEC Director (Sept. 7, 2017) (on file with TAS); email communication to TAS from SPEC Senior Tax Analyst (Sept. 29, 2017) (on file with TAS). Instead, the IRS will offer webcaster VITA training to personnel in South Korea. See email communication to TAS from Tax Counsel, Under Secretary of Defense (USD), Personnel and Readiness (P&R), Legal Policy, Pentagon (Dec. 15, 2017) (on file with TAS). Notably, there are approximately 20,000 service members and 23,800 U.S. civilians living, at the invitation of the U.S. Government, in South Korea. The DoD, at least currently, is actively assigning and moving these employees and families to South Korea and has deemed it safe to do so. Email communication to TAS from Director, Armed Forces Tax Council, Office of the Secretary of Defense, Department of Defense (Sept. 8, 2017) (on file with TAS).

85 Generally, these are uniformed attorneys, although civilian DoD attorneys working abroad may step in to teach tax law.

86 The U.S. attorneys may be either civilian or military attorneys.

87 Email communication to TAS from Chief, Personnel, Plans & Training Office, Office of the Judge Advocate General, United States Army (Sept. 26, 2017) (on file with TAS).

88 Budget constraints have also made it difficult for the IRS to provide in-person training for military VITA volunteers domestically. As such, SPEC has teamed up with the American Bar Association (ABA) Section of Taxation and law firms in recent years to instruct tax law to military VITA personnel, who prepare returns for other military personnel and their dependents. Although this model appears to work for many installations, the ABA struggles to continually recruit lawyers for these pro bono opportunities. See American Bar Association's description of the Adopt-a-Base Program at [https://www.americanbar.org/groups/taxation/tax\\_pro\\_bono/assist\\_service\\_members.html](https://www.americanbar.org/groups/taxation/tax_pro_bono/assist_service_members.html). See also C. Well Hall, III, *Uncle Sam: We Need a Few Good Tax Lawyers — Military VITA Training Opportunities Through the "Adopt-A-Base" Program*, ABA Section of Taxation NewsQuarterly, 10-12 (Spring 2015).

89 Military OneSource provides a variety of service resources to active-duty service members, to include free federal and state tax preparation through H&R Block software. There are no income nor age restrictions for service members and their families. See IRM 22.30.1.3.1.1.10, *Facilitated Self Assistance Software Programs* (Sept. 26, 2016).

90 Email communication to TAS from Branch Chief, Administration and Communication, Office of the Assistant Secretary of Defense, the office that administers the Military OneSource program (Sept. 11, 2017) (on file with TAS).

91 *Id.*

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Even if service members stationed abroad were some of the lucky 40 percent who got through to the IRS, they cannot be confident the IRS employees on the other end of the line understand their issue.

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January through October. However, these consultants are neither tax attorneys nor tax preparers and can answer only basic procedural questions.

Each year, the IRS receives more than 100 million telephone calls on its toll-free lines, roughly five million taxpayer visits in its taxpayer assistance centers (TACs), and some ten million pieces of correspondence from taxpayers responding to proposed adjustment notices.<sup>92</sup> The IRS received about 8.6 million calls on its “Installment Agreement/Balance Due” line, which taxpayers generally call if they cannot pay their tax liabilities in full and are seeking to arrange a payment plan.<sup>93</sup> The IRS answered 42 percent of these calls during FY 2017 (down from 44 percent in FY 2016), and wait times increased from 22 minutes in FY 2016 to 33 minutes in FY 2017.<sup>94</sup>

Service members face uncommon tax law questions about complex tax issues, including questions associated with return filing, audits, math error adjustments, penalty assessments, and collection issues. Even if service members stationed abroad were some of the lucky 40 percent who got through to the IRS, they cannot be confident the IRS employees on the other end of the line understand their issue. Additionally, military taxpayers stationed abroad generally cannot call U.S. toll-free telephone lines.<sup>95</sup> Moreover, because service members have until June 15 each year to file their tax returns, and IRS employees are prohibited from answering any tax law questions outside the domestic filing season (January 1–April 15), there are two months that service members have nowhere to turn *during the overseas filing season*.<sup>96</sup> This does not even take into account the additional six months outside the filing season, during which they have few tax resources available to them.

## CONCLUSION

Military tax law is a very complicated area of tax law, and members of the military and their families face unusual difficulties in meeting their tax obligations. To better address the complexity of these issues, the IRS should provide accurate, up-to-date information for military taxpayers. Ample funds should be provided to SPEC for the specific purpose of training military tax preparers at overseas locations, as well as hiring veterans who are specifically charged with outreach, education, and training for military taxpayers. There needs to be a dedicated service line for the military, staffed with people familiar with the various provisions, exclusions, and exceptions, who can route the service member taxpayer to the place he or she can go to resolve issues quickly. Additionally, there should be a specific individual in the IRS who is charged with updating the information geared towards service members on [irs.gov](https://www.irs.gov), to keep it current with developments in this important area of the law. The IRS should strive to be a part of the military community and display a desire to work with and educate service members. By

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92 National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress 6-28.

93 IRS, JOC, Snapshot Reports: Product Line Detail Snapshot (week ending Sept. 30, 2017).

94 *Id.*

95 National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress 6, 27.

96 Service members stationed abroad for the entire tax year are automatically granted two more months, until June 15, to file their returns. See Treas. Reg. § 1.6081-5(a)(6); see also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).

doing so, the IRS will assist a significant number of taxpayers with noteworthy and oftentimes complex tax issues, thereby building trust and improving compliance among this population.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Assign a dedicated IRS employee to routinely update the military information on irs.gov website.
2. Create a special unit of SPEC staffed with veterans whose responsibilities are to develop and conduct outreach, education, and assistance to current military taxpayers, including National Guard and Reservists, and to those organizations that provide tax assistance to these taxpayers.
3. Allocate ample funding for SPEC to provide face-to-face training for military VITA volunteers in overseas locations.
4. Provide a year-round dedicated toll-free telephone line for service members and their families to answer tax law and filing questions, and to resolve their tax account and compliance issues.