

**TECHNICAL EXPLANATION  
OF H.R. 5557,  
THE “ARMED FORCES TAX FAIRNESS ACT OF 2002”**

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of the  
JOINT COMMITTEE ON TAXATION



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**CONTENTS**

	<u>Page</u>
INTRODUCTION .....	1
I. IMPROVING TAX EQUITY FOR MILITARY PERSONNEL .....	2
A. Exclusion of Gain on Sale of a Principal Residence by a Member of the Uniformed Services or the Foreign Service (sec. 2 of the bill and sec. 121 of the Code).....	2
B. Exclusion from Gross Income of Certain Death Gratuity Payments (sec. 3 of the bill and sec. 134 of the Code).....	3
C. Exclusion for Amounts Received Under Department of Defense Homeowners Assistance Program (sec. 4 of the bill and sec. 132 of the Code).....	4
D. Expansion of Combat Zone Filing Rules to Contingency Operations (sec. 5 of the bill and sec. 7508 of the Code).....	5
E. Modification of Membership Requirement for Exemption From Tax for Certain Veterans’ Organizations (sec. 6 of the bill and sec. 519 of the Code).....	8
F. Clarification of Treatment of Certain Dependent Care Assistance Programs Provided to Members of the Uniformed Services of the United States (sec. 7 of the bill and sec. 134 of the Code) .....	9
G. No Impact on Social Security Trust Funds Under Title II of the Social Security Act (sec. 8 of the bill) .....	10

## INTRODUCTION

This document<sup>1</sup>, prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of H.R. 5557, the “Armed Forces Tax Fairness Act of 2002.”

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of H.R. 5557, the “Armed Forces Tax Fairness Act of 2002”* (JCX-92-02), October 7, 2002.

## **I. IMPROVING TAX EQUITY FOR MILITARY PERSONNEL**

### **A. Exclusion of Gain on Sale of a Principal Residence by a Member of the Uniformed Services or the Foreign Service (sec. 2 of the bill and sec. 121 of the Code)**

#### **Present Law**

Under present law, an individual taxpayer may exclude up to \$250,000 (\$500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances, is able to exclude an amount equal to the fraction of the \$250,000 (\$500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met. There are no special rules relating to members of the uniformed services or the Foreign Service of the United States.

#### **Description of Proposal**

Under the proposal, an individual may elect to suspend for a maximum of five years the five-year test period for ownership and use during certain absences due to service in the uniformed services, or Foreign Service of the United States. The uniformed services include: (1) the armed forces (the Army, Navy, Air Force, Marine Corps, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service. If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to five years during which the taxpayer or the taxpayer's spouse is on qualified official extended duty as a member of the uniformed services, or in Foreign Service of the United States. For these purposes, qualified official extended duty is any period of extended duty by a member of the uniformed services, or the Foreign Service of the United States while serving at a place of duty at least 150 miles away from the taxpayer's principal residence or under orders compelling residence in Government furnished quarters. Extended duty is defined as any period of duty pursuant to a call or order to such duty for a period in excess of 180 days or for an indefinite period. The election may be made with respect to only one property for a suspension period.

#### **Effective Date**

The provision is effective for sales or exchanges after May 6, 1997.

**B. Exclusion from Gross Income of Certain Death Gratuity Payments  
(sec. 3 of the bill and sec. 134 of the Code)**

**Present Law**

Present law provides that qualified military benefits are not included in gross income. Generally, a qualified military benefit is any allowance or in-kind benefit (other than personal use of a vehicle) which: (1) is received by any member or former member of the uniformed services of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services; and (2) was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice which was in effect on such date. Generally, other than certain cost of living adjustments, no modification or adjustment of any qualified military benefit after September 9, 1986, is taken into account for purposes of this exclusion from gross income. Qualified military benefits include certain death gratuities.

**Description of Proposal**

The proposal extends the exclusion from gross income to any adjustment to the amount of the death gratuity payable under Chapter 75 of Title 10 of the United States Code, pursuant to a provision of law enacted before December 31, 1991, with respect to the death of certain members of the armed services on active duty, inactive duty training or engaged in authorized travel.

**Effective Date**

The provision is effective with respect to deaths occurring after September 10, 2001.

**C. Exclusion for Amounts Received Under  
Department of Defense Homeowners Assistance Program  
(sec. 4 of the bill and sec. 132 of the Code)**

**Present Law**

**HAP payment**

The Department of Defense Homeowners Assistance Program (“HAP”) provides payments to certain employees and members of the Armed Forces to offset the adverse effects on housing values that result from military base realignment or closure. The payments are authorized under the provisions of Title 42 U.S.C. section 3374.

HAP provides payments to eligible individuals who may, in general, either (1) receive a cash payment as compensation for losses that may be or have been sustained in a private sale, in an amount not to exceed the difference between (A) 95 percent of the fair market value of their property prior to public announcement of intention to close all or part of the military base or installation and (B) the fair market value of such property at the time of the sale, or (2) receive, as the purchase price for their property, an amount not to exceed 90 percent of the prior fair market value as such value is determined by the Secretary of Defense, or the amount of the outstanding mortgages.

**Tax treatment**

Unless specifically excluded, gross income for Federal income tax purposes includes all income from whatever source derived. Amounts received under HAP are received in connection with the performance of services, and thus are includable in gross income as compensation for services. Additionally, such payments are “wages” for Federal Insurance Contributions Act tax purposes (including Medicare).

**Description of Proposal**

The proposal exempts from gross income amounts received under the Homeowners Assistance Program. Amounts received under the program are also not considered wages for Federal Insurance Contributions Act tax purposes (including Medicare).

**Effective Date**

The provision is effective for payments made after the date of enactment.

**D. Expansion of Combat Zone Filing Rules to Contingency Operations**  
**(sec. 5 of the bill and sec. 7508 of the Code)**

**Present Law**

**General time limits for filing tax returns**

Individuals generally must file their Federal income tax returns by April 15 of the year following the close of a taxable year (sec. 6072). The Secretary may grant reasonable extensions of time for filing such returns (sec. 6081). Treasury regulations provide an additional automatic two-month extension (until June 15 for calendar-year individuals) for United States citizens and residents in military or naval service on duty on April 15 of the following year (the otherwise applicable due date of the return) outside the United States (Treas. Reg. sec. 1.6081-5(a)(6)). No action is necessary to apply for this extension, but taxpayers must indicate on their returns (when filed) that they are claiming this extension. Unlike most extensions of time to file, this extension applies to both filing returns and paying the tax due.

Treasury regulations also provide, upon application on the proper form, an automatic four-month extension (until August 15 for calendar-year individuals) for any individual timely filing that form and paying the amount of tax estimated to be due (Treas. Reg. sec. 1.6081-4).

In general, individuals must make quarterly estimated tax payments by April 15, June 15, September 15, and January 15 of the following taxable year. Wage withholding is considered to be a payment of estimated taxes.

**Suspension of time periods**

In general, the period of time for performing various acts under the Internal Revenue Code, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax, is suspended for any individual serving in the Armed Forces of the United States in an area designated as a "combat zone" during the period of combatant activities (sec. 7508). An individual who becomes a prisoner of war is considered to continue in active service and is therefore also eligible for these suspension of time provisions. The suspension of time also applies to an individual serving in support of such Armed Forces in the combat zone, such as Red Cross personnel, accredited correspondents, and civilian personnel acting under the direction of the Armed Forces in support of those Forces. The designation of a combat zone must be made by the President in an Executive Order. The President must also designate the period of combatant activities in the combat zone (the starting date and the termination date of combat).

The suspension of time encompasses the period of service in the combat zone during the period of combatant activities in the zone, as well as (1) any time of continuous qualified hospitalization resulting from injury received in the combat zone<sup>2</sup> or (2) time in missing in action status, plus the next 180 days.

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<sup>2</sup> Two special rules apply to continuous hospitalization inside the United States. First, the suspension of time provisions based on continuous hospitalization inside the United States

The suspension of time applies to the following acts:

- (1) Filing any return of income, estate, or gift tax (except employment and withholding taxes);
- (2) Payment of any income, estate, or gift tax (except employment and withholding taxes);
- (3) Filing a petition with the Tax Court for redetermination of a deficiency, or for review of a decision rendered by the Tax Court;
- (4) Allowance of a credit or refund of any tax;
- (5) Filing a claim for credit or refund of any tax;
- (6) Bringing suit upon any such claim for credit or refund;
- (7) Assessment of any tax;
- (8) Giving or making any notice or demand for the payment of any tax, or with respect to any liability to the United States in respect of any tax;
- (9) Collection of the amount of any liability in respect of any tax;
- (10) Bringing suit by the United States in respect of any liability in respect of any tax; and
- (11) Any other act required or permitted under the internal revenue laws specified by the Secretary of the Treasury.

Individuals may, if they choose, perform any of these acts during the period of suspension.

Spouses of qualifying individuals are entitled to the same suspension of time, except that the spouse is ineligible for this suspension for any taxable year beginning more than two years after the date of termination of combatant activities in the combat zone.

### **Description of Proposal**

The proposal applies the special suspension of time period rules to persons deployed outside the United States away from the individual's permanent duty station while participating in an operation designated by the Secretary of Defense as a contingency operation or that

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are applicable only to the hospitalized individual; they are not applicable to the spouse of such individual. Second, in no event do the suspension of time provisions based on continuous hospitalization inside the United States extend beyond five years from the date the individual returns to the United States. These two special rules do not apply to continuous hospitalization outside the United States.

becomes a contingency operation. A contingency operation is defined<sup>3</sup> as a military operation that is designated by the Secretary of Defense as an operation in which members of the armed forces are or may become involved in military actions, operations, or hostilities against an enemy of the United States or against an opposing military force, or results in the call or order to (or retention on) active duty of members of the uniformed services during a war or a national emergency declared by the President or Congress.

#### **Effective Date**

The provision applies to any period for performing an act that has not expired before the date of enactment.

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<sup>3</sup> The definition is done by cross-reference to 10 U.S.C. 101.

**E. Modification of Membership Requirement for Exemption From Tax  
for Certain Veterans' Organizations  
(sec. 6 of the bill and sec. 519 of the Code)**

**Present Law**

Under present law, a veterans' organization as described in section 501(c)(19) of the Code generally is exempt from taxation. The Code defines such an organization as a post or organization of past or present members of the Armed Forces of the United States (1) that is organized in the United States or any of its possessions; (2) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and (3) that meets certain membership requirements. The membership requirements are that (1) at least 75 percent of the organization's members are past or present members of the Armed Forces of the United States, and (2) substantially all of the remaining members are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets. No more than 2.5 percent of an organization's total members may consist of individuals who are not veterans, cadets, or spouses, widows, or widowers of such individuals.<sup>4</sup>

Contributions to an organization described in section 501(c)(19) may be deductible for federal income or gift tax purposes if the organization is a post or organization of war veterans.<sup>5</sup>

**Description of Proposal**

The proposal permits ancestors or lineal descendants of past or present members of the Armed Forces of the United States or of cadets to qualify as members for purposes of the "substantially all" test. The proposal does not change the requirement that 75 percent of the organization's members must be past or present members of the Armed Forces of the United States.

**Effective Date**

The provision is effective for taxable years beginning after the date of enactment.

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<sup>4</sup> Treas. Reg. sec. 1.501(c)(19)-1(b)(2). The Treasury has not amended this regulation to reflect changes made by Pub. L. No. 97-248.

<sup>5</sup> Sec. 170(c)(3); sec. 2522(a)(4).

**F. Clarification of Treatment of Certain Dependent Care Assistance Programs  
Provided to Members of the Uniformed Services of the United States  
(sec. 7 of the bill and sec. 134 of the Code)**

**Present Law**

Present law provides that qualified military benefits are not included in gross income. Generally, a qualified military benefit is any allowance or in-kind benefit (other than personal use of a vehicle) which: (1) is received by any member or former member of the uniformed services of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services; and (2) was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice which was in effect on such date. Generally, other than certain cost of living adjustments, no modification or adjustment of any qualified military benefit after September 9, 1986, is taken into account for purposes of this exclusion from gross income.

**Description of Proposal**

The proposal clarifies that dependent care assistance provided under a dependent care assistance program (as in effect on the date of enactment of this proposal) for a member of the uniformed services by reason of such member's status or service as a member of the uniformed services is excludable from gross income as a qualified military benefit subject to the present-law rules. The uniformed services include: (1) the armed forces (the Army, Navy, Air Force, Marine Corps, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service. Amounts received under the program are also not considered wages for Federal Insurance Contributions Act tax purposes (including Medicare).

**Effective Date**

The provision is effective for taxable years beginning after December 31, 2001. No inference is intended as to the tax treatment of such amounts for prior taxable years.

**G. No Impact on Social Security Trust Funds Under Title II of the Social Security Act  
(sec. 8 of the bill)**

**Present Law**

Present law provides for the transfer of Social Security taxes and certain self-employment taxes to the Social Security trust funds. In addition, the income tax collected with respect to a portion of Social Security benefits included in gross income is transferred to the Social Security trust funds.

**Explanation of Provision**

The proposal provides that any amounts to be transferred to any trust fund under Title II of the Social Security Act are determined as if this proposal has not been enacted. This will ensure that the income and balances of those Social Security trust funds are not reduced as a result of this proposal.

**Effective Date**

The provision is effective on the date of enactment.