

DOING BATTLE WITH TAXES

Take time to examine available tax credits and deductions for service members, and keep more money for your family.

BY TOM GRAVES



AS tax time approaches, it's worthwhile for service members to examine how tax credits and deductions apply to them, and which ones will save money. Service members on active duty overseas, reservists who have traveled long distances to bases, and those receiving a Base Allowance for Housing, Uncle Sam has ways to keep your money in the bank.

In your account, not his.

Tax advisors remind their clients that one of the biggest mistakes people make is to only think about taxes at the end of the year or just before April 15.

"Keep taxes in mind year round," said June Walbert, a Certified Financial Planner with USAA. "Collect receipts on an ongoing basis. If I don't have to pay Uncle Sam that money, I figure I'm ahead."

Some deductions and credits apply strictly to service members. Combat pay, for example, is exempt from taxation, and applies to active duty pay earned when in a combat zone, even if only part of a month included duty in the combat zone. The re-upping bonus is also tax free if received in a combat zone.

Reservists who have been deployed for six months or more can

utilize a Qualified Retirement Fund distribution without penalty for early withdrawal, and they have two years to pay it back.

So that Individual Retirement Account or 401k can come in handy to restart a business that had to be shelved during a deployment. Repayment of retirement fund distributions does not affect limits to year-to-year contributions.

Financial advisers remind taxpayers to be aware of available tax credits. A credit offsets taxes you would owe, keeping all of its value in your pocket, so its impact is greater than a deduction, which merely reduces your taxable income.

A \$1,000 tax credit is worth \$1,000 to you, but a \$1,000 deduction will save you a third or less of that, depending on the proportion of income you pay in taxes.

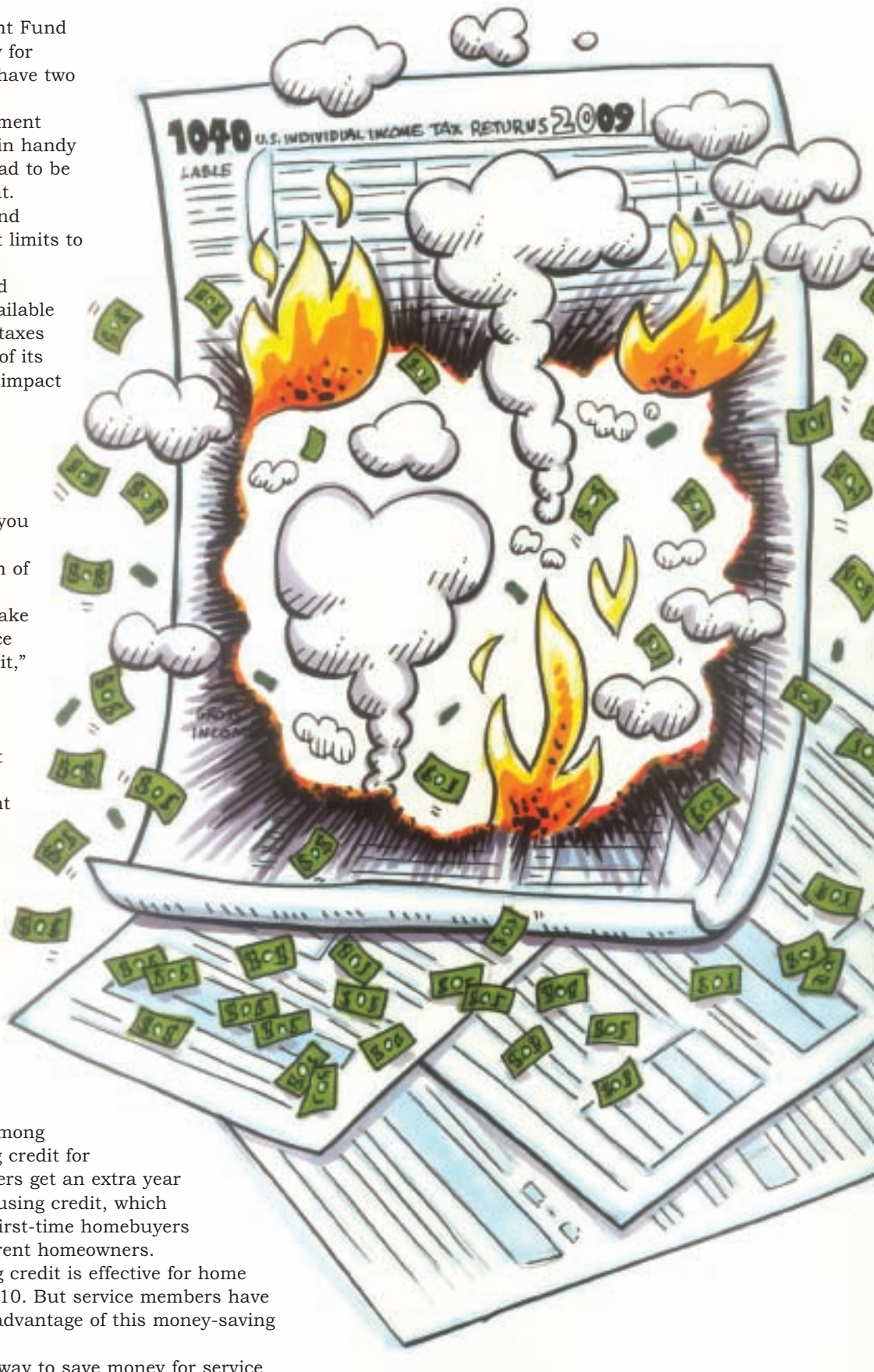
“One credit that could make a profound impact on service members is the saver’s credit,” Walbert said. “It is a way to shift money in your tax deductible retirement account and get a tax credit on it.”

To get full credit, the joint income limit for 2010 is \$33,000, or \$16,750 for singles. Service members who can contribute \$2,000 to an IRA or Thrift Savings Plan can get a \$1,000 tax credit. The saver’s credit phases out as income increases, but service members with incomes up to \$55,000 can get a partial credit, Walbert said.

One popular tax credit among U.S. civilians is the housing credit for homebuyers. Service members get an extra year to take advantage of the housing credit, which offers an \$8,000 credit for first-time homebuyers and a \$6,500 credit for current homeowners.

For civilians, the housing credit is effective for home purchases through April 2010. But service members have until June of 2011 to take advantage of this money-saving law.

Walbert pointed out one way to save money for service



Military Tax Tips

There are many ways that U.S. service members can defer expenses and decrease Federal taxes.

Moving Expenses: If you are on active duty and you move because of a permanent change of station, you can deduct the reasonable unreimbursed expenses of moving you and members of your household.

Combat Pay: If you serve in a combat zone as an enlisted person or as a warrant officer for any part of a calendar month, all your military pay received for military service that month is not taxable. For officers, the monthly exclusion is capped at the highest enlisted pay, plus any hostile fire or imminent danger pay received.

Extension of deadlines: The time for taking care of certain tax matters can be postponed. The deadline for filing tax returns, paying taxes, filing claims for refund, and taking other actions with the IRS is automatically extended for qualifying members of the military.

Uniform Cost and Upkeep: If military regulations prohibit you from wearing certain uniforms when off duty, you can deduct the cost and upkeep of those uniforms, but you must reduce your expenses by any allowance or reimbursement you receive.

Joint Returns: Generally, joint returns must be signed by both spouses. However, when one spouse may not be available due to military duty, a power of attorney may be used to file a joint return.

Travel to Reserve Duty: Reservists can deduct unreimbursed travel expenses for traveling more than 100 miles away from home to perform your reserve duties.

ROTC Students: Subsistence allowances paid to ROTC students participating in advanced training are not taxable. However, active duty pay – such as pay received during summer advanced camp – is taxable.

Transitioning Back to Civilian Life: You may be able to deduct some costs you incur while looking for a new job. Expenses may include travel, resume preparation fees, and outplacement agency fees. Moving expenses may be deductible if your move is closely related to the start of work at a new job location and you meet certain tests.

Tax Help: Military installations offer free tax filing and preparation assistance during the filing season.

Tax Information: IRS Publication 3, Armed Forces' Tax Guide summarizes many important military-related tax topics. Publication 3 is available for download at IRS.gov or may be ordered by calling 1-800-TAX-FORM (1-800-829-3676).

Source: www.irs.gov.

members that is easy to overlook. Service members can contribute up to \$5,000 per year of combat pay into a Roth IRA (\$6,000 if over age 50).

Since Roth IRA contributions are typically made after taxes are deducted, their retirement distributions are free of taxation.

Using combat pay makes the money “tax free going in and tax free coming out,” Walbert said. “This is a really critical advantage that is only available to the military.”

Keeping combat pay tax free is not always an advantage to the service member, said USAA Certified Financial Planner J.J. Montanaro.

“One option for someone in a modest income level is to declare the income if you qualify for the earned income tax credit,” Montanaro said.

The earned income tax credit may be more money than the savings of undeclared combat pay, so it’s worth calculating federal taxes both with combat pay declared and undeclared.

According to the IRS’ Armed Forces Tax Guide, “if your earned income without your combat pay is equal to or more than these amounts, you will not benefit from using your combat pay in your earned income:

- \$5,700 if you have no qualifying children
- \$8,550 if you have one qualifying child
- \$12,050 if you have two qualifying children.”

(See sidebar for an example of the earned income tax credit.)

When looking for which expenses can be deducted and which cannot, the best rule to keep in mind is that reimbursed expenses are not deductible, and most unreimbursed expenses are deductible.

There’s at least one gray area for homeowners. Interest paid on a home loan is tax deductible, as it is for civilians, even if your house payment is reimbursed by the Department of Defense under Basic Allowance for Housing (BAH) limits.

Moving expenses that are not reimbursed are also deductible, but as with anything, keep those receipts and an accurate mileage log.

“If push comes to shove, you want to have a dependable record,” Montanaro said. “The whole log concept is a good one.”



Uniforms that cannot be worn in civilian life require care such as dry cleaning, and that is a deductible expense.

Association fees and education costs that are an integral part of one's duties as a service member are deductible expenses.

Reservists who travel more than 100 miles to a duty-station can


deduct mileage expenses at 55 cents per mile.

Also, service members deployed overseas have more time to file their tax returns than civilians: at least 180 days from the date of their return to the U.S.

The Armed Forces Tax Guide is a thorough source of information on many types of tax credits and

deductions and is available at www.irs.gov.

Keeping good records and keeping taxes in the back of your mind throughout the year are good habits to making the most out of your military tax benefits.

"There are often a lot of dollars left on Uncle Sam's table that you could have kept," Walbert said. 

Using the Earned Income Tax Credit

For service members with modest incomes, declaring tax-free combat pay may save money. Here is one example.

Taxpayer: Sergeant (E-5) with 5 years of service—married with 3 young children.

Scenario: Service member served 11 months in 2009 in combat zone/spouse did not work outside home in 2009. Figures use standard deduction.

E-5 over 4: \$2,334/month

Do not include tax-free income:

Adjusted Gross: \$2,334
Standard Deduction: \$11,400
Exemptions: \$18,250
Taxable Income: \$0
Taxes owed: \$0
Refundable tax credit received by service member: \$1,046

Include tax-free income:

Adjusted Gross: \$28,008
Standard Deduction: \$11,400
Exemptions: \$18,250
Taxable Income: \$0
Income Tax: \$0
Refundable Tax Credit received by service member: \$4,265

Source: www.irs.gov



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