Committee On Finance
Max Baucus, Chairman

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FACT SHEET
THE FOREIGN AND ARMED SERVICES TAX FAIRNESS ACT OF 2002

On September 3, 2002, the Finance Committee released the Chairman's Mark of the "Armed Forces Tax Fairness Act of 2002," H.R. 5063. The Chairman's Mark is based upon S.2816, a bill introduced by Senators Baucus and Grassley in July. The Finance Committee will mark up this legislation on Thursday, September 5, 2002.

The legislation focuses on correcting certain inequities in the tax code, as well as providing incentives for members of the armed forces to continue their service to America. The mark's tax cut and clarification provisions cost approximately $1 billion over 10 years. It includes the following provisions:

•**Death Gratuity Payments.** Under current law, death gratuity benefits are excludable from income only to the extent that they were as of September 9, 1986. In 1986, the death gratuity benefit was $3,000. In 1991, the benefit was increased to $6,000, but the tax code was never adjusted. The proposal would provide that all death gratuity payments are nontaxable.

•**Exclusion of Gain on the Sale of a Principal Residence**. In 1997, Congress passed legislation revising the taxation of capital gains on the sale of one's principal residence. The new rule is that up to $250,000 ($500,000 per couple) is excluded on that sale of a principal residence if the individual has lived in the house for at least two of the previous five years. When enacted, Congress failed to provide a special rule for military and foreign service personnel who are required to move either within the U.S. or abroad. The proposal would permit uniformed service personnel and members of the Foreign Service to suspend the five year period while away on assignment (those years would count toward neither the two years nor the five year periods).

•**Exclusion of Amounts Received Under Military Homeowners Assistance Program**. The Department of Defense provides payments to members of the Armed Services to offset diminution in housing values due to military base realignment or closure. For example, if a house near a base was worth $140,000 prior to the base closure and $100,000 after the base closure, DOD may provide the owner with a payment to offset most - but not all - of the $40,000 diminution in value. Under current law, those amounts are taxable as compensation. The proposal would provide that such payments are not includible into income.

•**Expand Combat Zone Filing Rules to Include Contingency Operations**. Under current law, military personnel in a combat zone are afforded an extended period for filing tax returns. However, this does not apply to contingency operations. The proposal would extend the same benefits to military personnel assigned to contingency operations.

•**Above-The Line-Deduction for Overnight Travel Expenses of National Guard and Reserve Members**. Some reservists who travel for reserve duty incur significant travel, lodging, and food expenses. Under current law, these are deductible as itemized deductions (category: unreimbursed business expenses) to the extent they exceed 2% of adjusted gross income. Most lower income reservists are among the 75% of taxpayers who do not itemize. For higher income reservists, the 2% floor limits the amount of the benefit of the deductions. The proposal would provide an above-the-line deduction for overnight travel costs and would be available for all reservists and members of the National Guard. The amount of deductible expenses may not exceed the general government per diem rates applicable to that locale.

•**Expansion of Membership for Veterans' Organizations**. Qualified veterans' organizations under section 501(c)(19) of the tax code are tax-exempt and contributions to the organization are tax-deductible. In order to qualify under 501(c)(19), the organization must meet several tests, including (1) 75% of the members must be current or former active military, and (2) substantially all of the members must be either current/former active military or widows/widowers of former active military. The proposal would permit lineal descendants and ancestors of current or former active military to qualify for the "substantially all" test.

•**Clarification of Treatment of Child Care Subsidies**. Under current law, employers may subsidize the child care costs of their employees (maximum of $5,000 per person) without the benefit being included in the taxable income of the employee. Employers must meet certain rules (e.g., subsidy must be provided to all workers, not just executives) in order to qualify. The military provides extensive child care benefits to its employees. There is a separate tax code provision that excludes from income benefits provided to members of the uniformed services. But it is unclear whether child care benefits are covered under this provision. The proposal would clarify that any child care benefit provided to military personnel would be excludible from income.

The following two provisions are included as a revenue offset:

•**Expatriation – Impose Mark-to-Market Tax on Individuals Who Expatriate**. Much like the corporations that expatriate for tax purposes, individuals may also expatriate, and current law applies a special set of rules to those individuals that expatriate for tax purposes. Under this regime, for 10 years after a US citizen expatriates with a principal purpose of avoiding US taxes, he/she is taxed on the sale of assets held at the time of expatriation. In addition, if the expatriate dies within 10 years of the expatriation, more types of assets are included in his/her estate than if expatriation had not occurred. The current law has been difficult to enforce. The Chairman's mark would change the rules so that the act of expatriation itself triggers the recognition of tax -- in other words, rather than collecting tax every time an asset is sold over the next decade, the bill treats all of the assets of an expatriate as having been sold the day prior to expatriation - thereby imposing a tax up front rather than over the course of time. On the estate tax side, rather than attempting to collect the tax from the estate of an expatriate not in US jurisdiction, the Chairman's mark taxes the inheritance of an heir remaining in the US in such a way as to remove any tax benefit from the expatriation. The regime in the Chairman's mark would replace current law on a prospective basis. It raises $656 million over 10 years.

•**Extension of IRS User Fees.** Under current law, the IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. For example, for a request for a letter ruling, fees range from $250 to $3650. The proposal would extend the statutory authorization for these user fees through September 30, 2012, and move the statutory authorization for these fees into the Internal Revenue Code. The proposal raises $341 million over 10 years.