

Tax Benefits of Fighting In A Combat Zone - 5/1/2001

by [Sandy Botkin](#)

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Although I am a small business and home-based business tax expert, I have recently received a lot of questions from friends wondering, "what are the tax benefits if I get called up for military service?" Considering that America may be at war in the near future and also considering that military pay will be a lot less than what many people would have been making in the private sector, I felt that this was an important issue that no one was addressing. Accordingly, this article will give you an overview of the many benefits available to you should you be serving in a war zone.

Generally, most military pay is included in income. However, to my surprise, there are a huge number of benefits available to military personnel serving in a combat zone. This list actually gets someone complicated because there is a wide variety of payments that the military makes available to their soldiers and also the tax consequences vary as to whether you are a commissioned officer or an enlisted soldier (non-commissioned officer)

1. **Combat pay and hostile fire pay:** All enlisted personnel (non-officers) can exclude from gross income any pay received while serving in a combat zone. This applies for each month that you were serving in the combat zone even if you were only there for one day in the month. This also applies if you were hospitalized due to injury occurred in the combat zone or if you developed a sickness or disease while in the combat zone. I should note that you are, however, taxed on this money for social security and for Medicare. (**Author's note:** I guess the government is really desperate to fund the social security fund after raiding it for some many years.

Commissioned officers have a slightly different deal. They can exclude from compensation the maximum amount the enlisted personnel would be paid at the highest pay grade plus any hazard duty pay or hostile fire pay. The highest enlisted amount as of the date of this article was \$4,893 per month.

2. **Payments made while hospitalized:** If you were injured in a combat zone or developed a disease incurred in a combat zone, you also exclude all income earned as noted above while you are hospitalized.

Example: John, becomes injured while serving in a combat zone. He spends one-year recuperating in a hospital from his injuries. All pay received during the period of hospitalization would be tax-free.

3. **Subsistence Allowances and Quarter's allowances:** These are excluded from gross income whether or not you serve in a combat zone. This applies to the Basic Housing Allowance, Basic Allowance for Subsistence, and for any Overseas housing allowance.
4. **Deduction for housing interest:** Even if you receive tax-free monies for housing and subsistence, you can still deduct the interest and taxes that you pay on your principal residence and on any second home that you have. (**Author's note:** This is not a bad deal).
5. **VA disability benefits:** Should you have a permanent disability that results in receipt in Veteran's benefits for disability, which is based on some percentage disability, these benefits would be tax-free. The key is that the disability payments must be based on a percentage of

disability. I should note that any payments made to US employees who are injured by a terrorist attack are also tax free if the person was a U.S. Employee and served outside the U.S.

6. **Reenlistment bonuses:** Generally any incentive bonuses for reenlistments are fully taxable. However, there is one BIG exception. If you reenlist while you are service in a combat zone, the whole bonus becomes tax-free even if the payment is made to you after you stop serving in a combat zone. (**Author's note:** Life is indeed strange).
7. **Retirement pay and pensions:** All retirement pay and pensions are taxable even if you served in a combat zone throughout your career. However, payments made for disability, if they are based on a percentage of disability, are tax-free.
8. **Dividends and proceeds from National Government Life Insurance:** Generally all dividends and endowments paid from a national service life insurance policy is tax-free.
9. **Death of a soldier or U.S Employee serving abroad:** Although this is not my favorite tax planning strategy, if a soldier dies in a combat zone as a result of any wounds incurred while serving in the combat zone, all income tax for the current year and all prior years (including prior year penalties and interest) are cancelled!. Thus, if you owe a lot of money to the US in past taxes, just die while in a combat zone to get them forgiven. Again, this is not my favorite technique. This same rule applies to any U.S. Employee serving outside of the country and dies from a terrorist activity and certain specified terrorist activities in the U.S, as well. (The two main specified activities that applies to terrorist activities in the U.S. are those that result from the Oklahoma City bombing and those killed in N.Y on September 11, 2001 in the World Trade Towers).

Author's Tip: If you are married to a service person that dies in a combat zone and have your taxes cancelled for the year of death, you should still file a tax return. You won't owe any taxes, but you will reduce any future IRS inquiry if a return is files with an accompanying note stating that the join filer was killed while in a combat zone.

10. **Burial and death services and allowances:** Any burial service and death gratuities are tax-free to all members of the armed forces

11. **All IRS examination and collection actions are suspended:** Are you worried about an IRS audit; or is IRS coming after you for a collection matter? Well, fret no more. If you serve in a combat zone, all IRS actions gets suspended for as long as you are serving in a combat zone or are continually hospitalized from injuries or sickness incurred while serving in a combat zone. (**Author's note:** I know most people hate being audited but this seems too drastic of a measure to fight in a combat zone simply to postpone an audit.)

12. **Moving and Storage Expenses:** Generally all moving and storage expenses furnished in-kind to any member of the armed forces are tax-free. Cash reimbursements are also tax-free if made on account of a transfer to a new permanent duty station.

12. **Extension of return and extension of payment:** You will really like this. You need not file any individual income, estate or gift tax return while you are serving in a combat zone or are hospitalized as a result of injure or sickness as a result of serving in a combat zone. The extension also gives you an extra 180 days from when you are no longer serving in the combat zone or no longer hospitalized from the injuries and sickness. This extension applies to both the filing of the return and to the payments of any tax due. This extension also applies to your spouse and to any tax returns that you would file for dependent children. Strangely this extension doesn't seem to apply to other types of tax returns such as corporate returns.

13. **Joint return filing for a spouse missing in action:** What happens if your spouse is missing in action or is a prisoner of war. Well, Congress thought of this too. If you have a spouse that is a prisoner of war or is “missing in action,” you may elect to file a joint tax return for each year up to two years from the end of the conflict in that zone.

Example: Sam is missing in action while serving in Iraq in 2003. Mary, his wife, may elect to file a join return for that year and for each year that the war goes on in Iraq and for a period of up to two years thereafter.

Whew, as you can see there is a lot of tax benefits that accrue to those who are serving in the military and especially those serving in a combat zone. Knowing what these benefits are and taking advantage of them can save you a bundle and make your life a lot less taxing.

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