

## **Other military tax benefits in the Heroes Earnings Assistance and Relief Tax Act of 2008**

Dear Reader,

The recently enacted "Heroes Earnings Assistance and Relief Tax Act of 2008" (the 2008 Heroes Act) contains a wide-ranging package of tax cuts for military personnel and veterans. While many of the military tax benefits are pension plan-related, several important changes are not. Specifically, the 2008 Heroes Act makes the following nonpension-related liberalizations for members of the military and their families:

- Clarifies that those in the active military who file a joint tax return are eligible for the stimulus rebate payment under the Economic Stimulus Act of 2008 even if one spouse does not have a Social Security number.
- Makes permanent the ability to include combat pay as earned income for purposes of the earned income tax credit (EITC) (under pre-2008 Heroes Act law this benefit was only available for tax years ending before 2008).
- Makes permanent an exception that permits qualified mortgage bonds to be issued to finance mortgages for qualified veterans who served in the active military without regard to the first-time homebuyer requirement (under pre-2008 Heroes Act law this exception only applied for bonds issued before 2008).
- Extends the limitations period for filing tax refund credit claims arising from Department of Veterans Affairs disability determinations. This provision is important because length-of-service-based military retirement benefits are included in income but veterans' benefits based on a service-connected disability are excluded. Where individuals receive includible retirement benefits and are later retroactively determined to be eligible for service-connected disability benefits, the retirement benefits attributable to the disability are retroactively excluded. Under pre-2008 Heroes Tax Act law, individuals may claim a refund of the tax paid on the retroactively excluded benefits, subject to the statute of limitations on filing a refund claim (generally, the claim must be filed within three years of the filing of the tax return or within two years of the payment of the tax, whichever expires later). Effective for claims filed after the enactment date, the Act extends the time period for filing a refund claim. For a determination after the enactment date, the period is extended until one year after the date of the disability determination (if later than the time periods allowed under current law). The change applies to any tax year which begins five years before the date of the determination or thereafter. For a determination after 2000, and on or before the enactment date, the refund period is extended until one year after the enactment date (if later than the time periods allowed under current law).
- Modifies the rules regarding differential pay. Some employers voluntarily agree to continue paying the compensation that service members would otherwise have received from the employer during their active duty. Under pre-2008 Heroes Act law, such "differential pay" isn't wages for federal income tax withholding purposes but under the new law is subject to withholding, effective for amounts paid after 2008. Additionally, effective for tax years beginning after 2008, differential pay will have to be treated as compensation for retirement plan purposes, and will qualify as compensation for purposes of the IRA contribution rules.
- Provides small employers with a 20% tax credit for differential wage payments made to employees who are on active military duty.
- Provides an exclusion for state or local payments of bonuses to active or former military personnel or their dependents on account of such military personnel's service in a combat zone.

- Allows members of the reserves who are called to active duty to withdraw unused amounts held in a health flexible spending account (health FSA).

Please keep in mind that this is only a summary of these changes in the new law. If you would like more details about these provisions or any other aspect of the new law, please do not hesitate to call.