

TAX RELIEF FOR MILITARY PERSONNEL AND THEIR FAMILIES

The recently enacted Heroes Earnings Assistance and Relief Tax Act of 2008 (“Heroes Act”) provides tax relief for military members and their families. The costs of the benefits provided by the Heroes Act are fully offset with tightened expatriation rules, a new rule requiring U.S. companies working under a U.S. government contract to treat overseas employees as subject to employment taxes, and a higher failure to file penalty. This is a summary of the most relevant provisions of the Heroes Act:

NEW RELIEF PROVISIONS

- 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. Under pre-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-Heroes Act law, this exception only applied for bonds issued before 2008.
 - Requires a tax-qualified retirement plan to provide that if a participant dies while performing qualified military service, his or her survivors are entitled to any additional benefits that would have been provided had he or she resumed employment and then terminated employment on account of death.
 - Provides that retirement plans can permit individuals who leave for qualified military service and cannot be reemployed on account of death or disability to be treated as if they had been rehired as of the day before death or disability and then had terminated employment on the date of death or disability.
 - Includes differential wages paid by an employer to an employee who becomes active duty military in the calculation of wages for retirement plan and Individual Retirement Account purposes. Differential pay is also made subject to federal income tax withholding.
 - Provides small employers with a 20% tax credit for differential wage payments made to employees who are on active military duty.
 - Extends the income exclusion of “qualified military benefits” to include any bonus payment made by a state or political subdivision to any member or former member of the U.S. uniformed services, or to his or her dependent, only by reason of the member’s service in a combat zone.
 - Extends the limitations period for filing tax refund credit claims arising from Department of Veterans Affairs disability determinations.
 - Makes permanent the expiring Internal Revenue Code provision that permits active duty reservists to make penalty-free withdrawals from retirement plans.
 - Permits a military death gratuity or amount received under the service-members’ group life insurance program to be rolled over to a Roth Individual Retirement Account or Coverdell education savings account, notwithstanding the contribution limits that otherwise apply.
 - Entitles Peace Corps volunteers and certain employees to a similar tolling of the home sale exclusion ownership and use period that already applies to members of the uniformed services, foreign service, and intelligence community.
 - Makes permanent the special home sale exclusion rules for certain employees of the intelligence community and repeals the requirement that those employees move overseas in order to qualify for special treatment.
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- Allows members of the reserves who are called to active duty to withdraw unused amounts held in a health flexible spending account.
- Retroactively clarifies that certain property tax rebates and other benefits made with respect to volunteer firefighters and emergency medical responders, and excluded from gross income under the Mortgage Forgiveness Debt Relief Act of 2007, are not subject to Social Security tax or unemployment tax.
- Allows veterans to receive mortgages financed by qualified mortgage bonds without regard to the three-year requirement for prior non-ownership of his or her principal residence.

REVENUE RAISING PROVISIONS

- Tightens the expatriation rules to ensure that certain high net-worth taxpayers cannot renounce their U.S. citizenship or terminate their U.S. residency in order to avoid U.S. taxes. Under this provision, high net worth

individuals are treated as if they sold all of their property for its fair market value on the day before they expatriate or terminate their residency. Gain is recognized to the extent that the aggregate gain recognized exceeds \$600,000.

- Provides an additional transfer tax on certain covered gifts or bequests received by a U.S. citizen or resident.
- Treats foreign subsidiaries of U.S. companies performing services under a U.S. government contract as U.S. employers for employment tax purposes. Under the new law, the domestic parent is jointly liable for employment taxes imposed on the foreign subsidiary.
- Increases the minimum penalty for a failure to file an individual tax return within 60 days of the due date to the lesser of \$135 (up from \$100) or 100 percent of the amount of tax required to be shown on the return.

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