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Armed Forces' Tax Guide

For use in preparing

2003 Returns



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Contents

Important Changes for 2003	2
Important Reminders	2
Introduction	3
Gross Income	3
Foreign Source Income	5
Community Property	5
Adjustments to Income	5
Armed Forces Reservists	5
Individual Retirement Arrangements	6
Moving Expenses	6
Combat Zone Exclusion	7
Combat Zone	7
Serving in a Combat Zone	8
Amount of Exclusion	8
Alien Status	8
Resident Aliens	9
Nonresident Aliens	9
Dual-Status Aliens	9
Exemptions	9
Dependents	10
Sale of Home	12
Rules for Sales in 2003	12
Rules for Sales Before May 7, 1997	12
Itemized Deductions	18
Miscellaneous Itemized Deductions	18
Credits	20
Earned Income Credit	20
IRS Will Figure Your Credit for You	23
Advance Earned Income Credit	23
Child Tax Credit	23
Decedents	24
Combat Zone Tax Forgiveness	24
Terrorist or Military Action Tax Forgiveness	25
Claims for Tax Forgiveness	25
Filing Returns	26
Where To File	26
When To File	26
Extensions	26
Signing Returns	27
Refunds	28
Extension of Deadline	28
Service That Qualifies for an Extension of Deadline	28
Filing Returns for Combat Zone or Contingency Operation Participants	30
How To Get Tax Help	30
Index	32

Important Changes for 2003

Servicemembers Civil Relief Act. As a member of the Armed Forces, you may be able to defer (delay) payment of income tax that becomes due before or during your military service for up to 180 days after termination or release from service. For more information, see *Not in a combat zone* under *Extension of Deadline*.

Military Family Tax Relief Act of 2003. The Military Family Tax Relief Act of 2003 provides the following tax relief for members of the Armed Forces and their families.

- The death gratuity paid to a survivor of a member of the Armed Forces who died after September 10, 2001, increased to \$12,000 and is all nontaxable. Previously, the death gratuity was \$6,000 and only \$3,000 of it was nontaxable. So, you may be able to claim a refund if you paid tax on a death gratuity you received because of a death that occurred after September 10, 2001.
- The 5-year period used in determining whether you can exclude gain from the sale of your main home may be suspended during the period you or your spouse served on qualified official extended duty as a member of the Armed Forces. This change applies to any sale of a main home after May 6, 1997, so you may be able to claim a refund if you paid tax on a gain from a sale after that date. For details, see *Sale of Home*, later.
- A military base realignment and closure benefit generally is excludable from income if paid to you after November 11, 2003. See *Moving allowances* in *Table B* and *Military base realignment and closure benefit*, later.
- The extension of the deadline for filing a return for members of the Armed Forces serving in a combat zone now also applies to members of the Armed Forces serving in a contingency operation. See *Extension of Deadline*, later.
- Benefits received after 2002 under a dependent-care assistance program are nontaxable.
- Beginning in 2003, you may not have to pay the additional tax of 10% on the part of a distribution from a qualified tuition program (QTP) or a Coverdell education savings account (ESA) that is includible in gross income. You will not have to pay the additional tax if your distribution was made on account of the attendance of the designated beneficiary at one of the three military academies, the Coast Guard academy, or the Merchant Marine academy, and the payment or distribution does not exceed the costs of advanced education attributable to that attendance. For more information about Coverdell ESAs, see chapter 7 of Publication 970, *Tax Benefits for Education*. For more information about QTPs, see chapter 8 of Publication 970.
- As a member of a reserve component of the Armed Forces, you can deduct travel expenses for any period during which you are more than 100 miles away from home in connection with your reserve duties on

line 33 of Form 1040, rather than as a miscellaneous itemized deduction on Schedule A (Form 1040). For more information, see *Armed Forces Reservists* under *Adjustments to Income*.

Lower income tax rates. For 2003, most tax rates have been reduced. The lower rates are reflected in the Tax Table and Tax Rate Schedules in your tax forms instructions.

Child tax credit. For 2003, the maximum child tax credit has been increased to \$1,000 for each qualifying child. But you must reduce your credit by any advance payment you received in 2003. For more information, see *Child Tax Credit* under *Credits*, later.

Tax rates for capital gains and dividends. For capital gains after May 5, 2003, the 10% maximum capital gain rate is reduced to 5% and the 20% rate is reduced to 15%. For more information, see *Capital Gain Tax Rates* in Publication 550, *Investment Income and Expenses*.

For 2003, qualified dividend income is taxed at the new capital gain rates. See *Qualified Dividend Income* in Publication 550.

Standard mileage rate. The standard mileage rate for the cost of operating your car decreased to 36 cents a mile for all business miles driven. The standard mileage rate for operating your car to get medical care or to move decreased to 12 cents a mile.

Earned income credit. The maximum amount of income you can earn and still claim the earned income credit has increased. You may be able to take the credit if you earned less than \$33,692 (\$34,692 for married filing jointly) if you have two or more qualifying children; \$29,666 (\$30,666 for married filing jointly) if you have one qualifying child; and, \$11,230 (\$12,230 for married filing jointly) if you do not have any qualifying children. See *Earned Income Credit*, later.

Exemption amount. You are allowed a \$3,050 deduction for each exemption to which you are entitled.

Lifetime learning credit. The maximum lifetime learning credit has increased to \$2,000 (20% of up to \$10,000 of qualified tuition and related expenses). For details, see Publication 970.

Important Reminders

Third party designee. You can check the Yes box in the *Third Party Designee* area of your return to authorize the IRS to discuss your return with a friend, family member, or any other person you choose. This allows the IRS to call the person you identified as your designee to answer any questions that may arise during the processing of your tax return. It also allows your designee to perform certain actions. See the income tax package for details.

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help

bring these children home by looking at the photographs and calling **1-800-THE-LOST (1-800-843-5678)** if you recognize a child.

Introduction

This publication covers the special tax situations of active members of the U.S. Armed Forces. It does not cover military pensions or veterans' benefits or give the basic tax rules that apply to all taxpayers. For information on military pensions or veterans' benefits, see Publication 525, *Taxable and Nontaxable Income*. If you need the basic tax rules or information on another subject not covered here, you can check our other free publications. See Publication 910, *IRS Guide to Free Tax Services*, for a list and descriptions of the different tax publications.

For federal tax purposes, the U.S. Armed Forces includes commissioned officers, warrant officers, and enlisted personnel in all regular and reserve units under control of the Secretaries of the Defense, Army, Navy, and Air Force. The U.S. Armed Forces also includes the Coast Guard. It does not include members of the U.S. Merchant Marine or the American Red Cross.

Members serving in an area designated or treated as a combat zone are granted special tax benefits. In the event an area ceases to be a combat zone (by Presidential Executive Order or by statute), the IRS will do its best to notify you. Many of the relief provisions will end at that time.

Members serving in a **qualified hazardous duty area** designated by statute are afforded the same benefits as members serving in a **combat zone** designated by Executive Order.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can e-mail us at ***taxforms@irs.gov**. Please put "Publications Comment" on the subject line.

You can write to us at the following address:

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Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

Useful Items

You may want to see:

Publication

- ☐ **54** Tax Guide for U.S. Citizens and Resident Aliens Abroad
- ☐ **463** Travel, Entertainment, Gift, and Car Expenses
- ☐ **501** Exemptions, Standard Deduction, and Filing Information

- ☐ **503** Child and Dependent Care Expenses
- ☐ **505** Tax Withholding and Estimated Tax
- ☐ **516** U.S. Government Civilian Employees Stationed Abroad
- ☐ **519** U.S. Tax Guide for Aliens
- ☐ **521** Moving Expenses
- ☐ **523** Selling Your Home
- ☐ **525** Taxable and Nontaxable Income
- ☐ **527** Residential Rental Property
- ☐ **529** Miscellaneous Deductions
- ☐ **553** Highlights of 2003 Tax Changes
- ☐ **559** Survivors, Executors, and Administrators
- ☐ **590** Individual Retirement Arrangements (IRAs)
- ☐ **596** Earned Income Credit (EIC)
- ☐ **970** Tax Benefits for Education
- ☐ **3920** Tax Relief for Victims of Terrorist Attacks

Form (and Instructions)

- ☐ **1040X** Amended U.S. Individual Income Tax Return
- ☐ **1310** Statement of Person Claiming Refund Due a Deceased Taxpayer
- ☐ **2688** Application for Additional Extension of Time To File U.S. Individual Income Tax Return
- ☐ **2848** Power of Attorney and Declaration of Representative
- ☐ **3903** Moving Expenses
- ☐ **4868** Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
- ☐ **8822** Change of Address
- ☐ **9465** Installment Agreement Request

See *How To Get Tax Help*, near the end of this publication, for information about getting IRS publications and forms.

Gross Income

Members of the Armed Forces receive many different types of pay and allowances. Some are included in gross income while others are excluded from gross income. Included items (*Table A*) are subject to tax and must be reported on your tax return. Excluded items (*Table B*) are not subject to tax, but may have to be shown on your tax return.

For information on the exclusion of pay for service in a combat zone and other tax benefits for combat zone participants, see *Combat Zone Exclusion and Extension of Deadline*, later.

Table A. Included Items

These items are included in gross income, **unless** the pay is for service in a combat zone.

Basic pay • Active duty • Attendance at a designated service school • Back wages • Drills • Reserve training • Training duty	Bonuses • Career status • Enlistment • Officer • Overseas extension • Reenlistment
Special pay • Aviation career incentives • Career sea • Diving duty • Foreign duty (outside the 48 contiguous states and the District of Columbia) • Foreign language proficiency • Hardship duty • Hostile fire or imminent danger • Medical and dental officers • Nuclear-qualified officers • Optometry • Overseas extension • Pharmacy • Special duty assignment pay • Veterinarian	Other payments • Accrued leave • High deployment per diem • Personal money allowances paid to high-ranking officers • Student loan repayment from programs such as the Department of Defense Educational Loan Repayment Program when year's service (requirement) is not attributable to a combat zone • CONUS COLA Incentive pay • Submarine • Flight • Hazardous duty • High altitude/Low altitude (HALO)

Table B. Excluded Items

The exclusion for certain items applies whether the item is furnished in kind or is a reimbursement or allowance. There is no exclusion for the personal use of a government-provided vehicle.

Living allowances • BAH (Basic Allowance for Housing). You can deduct mortgage interest and real estate taxes on your home even if you pay these expenses with your BAH • BAS (Basic Allowance for Subsistence) • Housing and cost-of-living allowances abroad whether paid by the U.S. Government or by a foreign government • OHA (Overseas Housing Allowance)	Combat zone pay • Compensation for active service while in a combat zone or a qualified hazardous duty area. Note: Limited amount for officers
Moving allowances • Dislocation • Military base realignment and closure benefit paid after November 11, 2003 (the exclusion is limited as described on page 5) • Move-in housing • Moving household and personal items • Moving trailers or mobile homes • Storage • Temporary lodging and temporary lodging expenses	Family allowances • Certain educational expenses for dependents • Emergencies • Evacuation to a place of safety • Separation
Travel allowances • Annual round trip for dependent students • Leave between consecutive overseas tours • Reassignment in a dependent restricted status • Transportation for you or your dependents during ship overhaul or inactivation • Per diem	Death allowances • Burial services • Death gratuity payments to eligible survivors • Travel of dependents to burial site Other payments • Defense counseling • Disability, including payments received for injuries incurred as a direct result of a terrorist or military action • Group-term life insurance • Professional education • ROTC educational and subsistence allowances • Survivor and retirement protection plan premiums • Uniform allowances • Uniforms furnished to enlisted personnel In-kind military benefits • Dependent-care assistance program • Legal assistance • Medical/dental care • Commissary/exchange discounts • Space-available travel on government aircraft

Claim for death gratuity refunds. In 2003, the death gratuity paid to a survivor of a member of the Armed Forces who died after September 10, 2001, was increased to \$12,000 and was made nontaxable. Previously, the death gratuity was \$6,000 and only \$3,000 of it was nontaxable. So, you may be able to claim a refund if you paid tax on a death gratuity you received due to the death of a member of the Armed Forces after September 10, 2001. If you are entitled to a refund, complete and file Form 1040X, *Amended U.S. Individual Income Tax Return*. At the top of Form 1040X, write "Military Family Tax Relief Act" in red. Generally, you must file a claim for credit or refund within 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later.

Military base realignment and closure benefit. Payments made under the Homeowners Assistance Program (HAP) after November 11, 2003, generally are excluded from income. However, the excludable amount cannot be more than the following limit:

- 95% of the fair market value of the property for which the payments were made, as determined by the Secretary of Defense before public announcement of intent to close all or part of the military base or installation, minus
- The fair market value of the property as determined by the Secretary of Defense at the time of sale.

Any part of the payment that is more than this limit is included in income.

Foreign Source Income

If you are a U.S. citizen with income from sources outside the United States (foreign income), you must report all of that income on your tax return unless it is exempt by U.S. law. This is true whether you reside inside or outside the United States and whether or not you receive a Form W-2, *Wage and Tax Statement*, or a Form 1099. This applies to earned income (such as wages and tips) as well as unearned income (such as interest, dividends, capital gains, pensions, rents, and royalties).

Certain taxpayers can exclude income earned in foreign countries. For 2003, this exclusion amount is \$80,000. However, the foreign earned income exclusion **does not** apply to the wages and salaries of military and civilian employees of the U.S. Government. Employees of the U.S. Government include those who work at Armed Forces post exchanges, officers' and enlisted personnel clubs, and embassy commissaries, and similar personnel paid from nonappropriated funds. Other foreign income earned by military personnel or their spouses may be eligible for the foreign earned income exclusion. For more information on the exclusion, get Publication 54.

Residents of American Samoa may be able to exclude income from Guam, American Samoa, and the Northern Mariana Islands. This possession exclusion does not apply to wages and salaries of military and civilian employees of the U.S. Government. If you need information on the possession exclusion, get Publication 570, *Tax Guide for Individuals With Income From U.S. Possessions*.

Community Property

The pay you earn as a member of the Armed Forces may be subject to community property laws depending on your marital status, your domicile, and the nature of the payment. The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

Marital status. Community property rules apply to married persons whose domicile during the tax year was in a community property state. The rules may affect your tax liability if you file separate returns or are divorced during the year.

Domicile. Your domicile is the permanent legal home you intend to use for an indefinite or unlimited period, and to which, when absent, you intend to return. It is not always where you presently live.

Nature of the payment. Active duty military pay is subject to community property laws. Armed Forces retired or re-tainer pay may be subject to community property laws.

For more information on community property laws, get Publication 555, *Community Property*.

Adjustments to Income

Adjusted gross income is your total income minus certain adjustments. The following adjustments are of particular interest to members of the Armed Forces.

Armed Forces Reservists

If you are a member of a reserve component of the Armed Forces and you travel **more than 100 miles away from home** in connection with your performance of services as a member of the reserves, you can deduct your travel expenses as an adjustment to income on line 33 of Form 1040 rather than as a miscellaneous itemized deduction. The deduction is limited to the amount the federal government pays its employees for travel expenses. For more information about this limit, see *Per Diem and Car Allowances* in chapter 6 of Publication 463.

Member of a reserve component. You are a member of a reserve component of the Armed Forces if you are in the Army, Navy, Marine Corps, Air Force, or Coast Guard Reserve, the Army National Guard of the United States, the Air National Guard of the United States, or the Reserve Corps of the Public Health Service.

How to report. If you have reserve-related travel that takes you more than 100 miles from home, you should first complete Form 2106, *Employee Business Expenses*, or Form 2106-EZ, *Unreimbursed Employee Business Expenses*. Then include in the total on line 33 of Form 1040 your expenses for reserve travel over 100 miles from home, up to the federal rate, from line 10 of Form 2106 or line 6 of Form 2106-EZ. Write "RC" and the amount of these expenses in the space to the left of line 33 of Form 1040. Subtract this amount from the total on line 10 of Form 2106 or line 6 of Form 2106-EZ and deduct the balance as an itemized deduction on line 20 of Schedule A

Individual Retirement Arrangements

For purposes of a deduction for contributions to a traditional individual retirement arrangement (IRA), Armed Forces' members (including reservists on active duty for more than 90 days during the year) are considered to be active participants in an employer-maintained retirement plan.

Generally, you can deduct the lesser of the contributions to your traditional IRA for the year or the general limit (or spousal IRA limit, if applicable). However, **if you or your spouse was covered by an employer-maintained retirement plan** at any time during the year for which contributions were made, you may not be able to deduct all of the contributions. The Form W-2 you or your spouse receives from an employer has a box used to indicate whether you were covered for the year. The *Retirement plan* box should have a mark in it if you were covered.

Individuals serving in the U.S. Armed Forces or in support of the U.S. Armed Forces in designated combat zones have additional time to make a qualified retirement contribution to an IRA. For more information on this extension of deadline provision, see *Extension of Deadline*, later. For more information on IRAs, get Publication 590.

Moving Expenses

To deduct moving expenses, you generally must meet certain time and distance tests. However, if you are a member of the Armed Forces on active duty and you move because of a permanent change of station, you do not have to meet these tests. You can deduct your unreimbursed moving expenses on Form 3903.

Permanent change of station. A permanent change of station includes:

- A move from your home to your first post of active duty,
- A move from one permanent post of duty to another, and
- A move from your last post of duty to your home or to a nearer point in the United States. The move must occur within one year of ending your active duty or within the period allowed under the Joint Federal Travel Regulations.

Spouse and dependents. If a member of the Armed Forces deserts, is imprisoned, or dies, a permanent change of station for the spouse or dependent includes a move to:

- The place of enlistment,
- The member's, spouse's, or dependent's home of record, or
- A nearer point in the United States.

If the military moves your spouse and dependents to or from a different location than you, the moves are treated as a single move to your new main job location.

Services or reimbursements provided by the government. Do not include in your income the value of moving and storage services provided by the government because of a permanent change of station. Similarly, do not include in income amounts received as a dislocation allowance, temporary lodging expense, temporary lodging allowance, or move-in housing allowance. Generally, if the total reimbursements or allowances that you receive from the government because of the move are more than your actual moving expenses, the excess is included in your wages on Form W-2. However, if any reimbursements or allowances (other than dislocation, temporary lodging, temporary lodging expense, or move-in housing allowances) exceed the cost of moving and the excess is not included in your Form W-2, the excess still must be included in gross income on line 7 of Form 1040.

Use Form 3903 to deduct qualified expenses that exceed your reimbursements and allowances (including dislocation, temporary lodging, temporary lodging expense, or move-in housing allowances that are excluded from gross income).

If you must relocate and your spouse and dependents move to or from a different location, do not include in income reimbursements, allowances, or the value of moving and storage services provided by the government to move you and your spouse and dependents to and from the separate locations.

Do not deduct any expenses for moving services that were provided by the government, or that were reimbursed to you, that you did not include in income.

Deductible moving expenses. If you meet the requirements discussed earlier, you can deduct the reasonable unreimbursed expenses that are incurred by you and members of your household.

You can deduct expenses (if not reimbursed or furnished in kind) for the following items.

- Moving household goods and personal effects, including expenses for hauling a trailer, packing, crating, in-transit storage, and insurance. You cannot deduct expenses for moving furniture or other goods you bought on the way from the old home to the new home.
- Travel and lodging expenses from the old home to the new home, including automobile expenses (either actual expenses or 12 cents per mile) and air fare. You cannot deduct any expenses for meals. You cannot deduct the cost of unnecessary side trips or lavish and extravagant lodging.



You can include only the cost of storing and insuring household goods and personal effects within a period of 30 consecutive days after the day these goods and effects are moved from your former home and before they are delivered to your new home.

Member of your household. A member of your household is anyone who has both your former home and your new home as his or her main home. It does not include a tenant or employee unless you can claim that person as a dependent.

Foreign moves. A foreign move is a move from the United States or its possessions to a foreign country or

from one foreign country to another foreign country. It is not a move from a foreign country to the United States or its possessions.

For a foreign move, the deductible moving expenses described earlier are expanded to include the reasonable expenses of:

- Moving your household goods and personal effects to and from storage, and
- Storing these items for part or all of the time the new job location remains your main job location. The new job location must be outside the United States.

Reporting moving expenses. Figure moving expense deductions on Form 3903. Carry the deduction from Form 3903 to line 27, Form 1040. For more information, get Publication 521 and Form 3903.

Combat Zone Exclusion

If you are a member of the U.S. Armed Forces who serves in a combat zone (defined later), you can exclude certain pay from your income. You do not have to receive the pay while you are in a combat zone, are hospitalized, or in the same year you served in a combat zone. However, your entitlement to the pay must have fully accrued in a month during which you served in the combat zone or were hospitalized as a result of wounds, disease, or injury incurred while serving in the combat zone. Enlisted personnel, warrant officers, and commissioned warrant officers can exclude the following amounts from their income. (Other officer personnel are discussed later.)

- Active duty pay earned in any month you served in a combat zone.
- Imminent danger/hostile fire pay.
- A reenlistment bonus if the voluntary extension or reenlistment occurs in a month you served in a combat zone.
- Pay for accrued leave earned in any month you served in a combat zone. The Department of Defense must determine that the unused leave was earned during that period.
- Pay received for duties as a member of the Armed Forces in clubs, messes, post and station theaters, and other nonappropriated fund activities. The pay must be earned in a month you served in a combat zone.
- Awards for suggestions, inventions, or scientific achievements you are entitled to because of a submission you made in a month you served in a combat zone.
- Student loan repayments. If the entire year of service required to earn the repayment was performed in a combat zone, the entire payment made because of that year of service is excluded. If only part of that year of service was performed in a combat zone, only part of the repayment qualifies for exclusion.

Retirement pay and pensions do not qualify for the combat zone exclusion.

Partial (month) service. If you serve in a combat zone for any part of one or more days during a particular month, you are entitled to an exclusion for that entire month.

Combat Zone

A combat zone is any area the President of the United States designates by Executive Order as an area in which the U.S. Armed Forces are engaging or have engaged in combat. An area usually becomes a combat zone and ceases to be a combat zone on the dates the President designates by Executive Order.

Afghanistan area. By Executive Order No. 13239, Afghanistan (and airspace above) was designated as a combat zone beginning September 19, 2001.

The Kosovo area. By Executive Order No. 13119 and Public Law 106–21, the following locations (including air space above) were designated as a combat zone and a qualified hazardous duty area beginning March 24, 1999.

- Federal Republic of Yugoslavia (Serbia/Montenegro).
- Albania.
- The Adriatic Sea.
- The Ionian Sea—north of the 39th parallel.

Persian Gulf area. By Executive Order No. 12744, the following locations (and airspace above) were designated as a combat zone beginning January 17, 1991.

- The Persian Gulf,
- The Red Sea,
- The Gulf of Oman,
- The part of the Arabian Sea that is north of 10 degrees north latitude and west of 68 degrees east longitude,
- The Gulf of Aden, and
- The total land areas of Iraq, Kuwait, Saudi Arabia, Oman, Bahrain, Qatar, and the United Arab Emirates.

Qualified hazardous duty area. Beginning November 21, 1995, a qualified hazardous duty area in the former Yugoslavia is treated as if it were a combat zone. The qualified hazardous duty area includes:

- Bosnia and Herzegovina,
- Croatia, and
- Macedonia.

Note. Members of the Armed Forces deployed overseas away from their permanent duty station in support of operations in a qualified hazardous duty area, but outside the qualified hazardous duty area, are treated as if they are in a combat zone solely for the purposes of the extension

of deadlines. These personnel are not entitled to other combat zone tax benefits. However, if they satisfy additional requirements, they may be entitled to full combat zone tax benefits. See *Qualifying service outside combat zone*, later.

Serving in a Combat Zone

Service in a combat zone includes any periods you are absent from duty because of sickness, wounds, or leave. If, as a result of serving in a combat zone, a person becomes a prisoner of war or is missing in action, that person is considered to be serving in the combat zone so long as he or she keeps that status for military pay purposes.

Note. You are considered to be serving in a combat zone if you are either assigned on official temporary duty to a combat zone or you qualify for hostile fire/imminent danger pay while in a combat zone.

Qualifying service outside combat zone. Military service outside a combat zone is considered to be performed in a combat zone if:

- The service is in direct support of military operations in the combat zone, and
- The service qualifies you for special military pay for duty subject to hostile fire or imminent danger.

Military pay received for this service will qualify for the combat zone exclusion if the other requirements are met and the pay is verifiable by reference to military pay records.

Nonqualifying presence in combat zone. None of the following types of military service qualify as service in a combat zone.

- Presence in a combat zone while on leave from a duty station located outside the combat zone.
- Passage over or through a combat zone during a trip between two points that are outside a combat zone.
- Presence in a combat zone solely for your personal convenience.

Amount of Exclusion

If you are an enlisted member, warrant officer, or commissioned warrant officer and you serve in a combat zone during any part of a month, all of your military pay for that month is excluded from your income. You also can exclude military pay earned while you are hospitalized as a result of wounds, disease, or injury incurred in the combat zone. The exclusion of your military pay while you are hospitalized does not apply to any month that begins more than 2 years after the end of combat activities in that combat zone. Your hospitalization does not have to be in the combat zone.

If you are a commissioned officer (other than a commissioned warrant officer), you may exclude your pay according to the rules just discussed. However, the amount of your exclusion is limited to the highest rate of enlisted pay (plus imminent danger/hostile fire pay you received) for

each month during any part of which you served in a combat zone or were hospitalized as a result of your service there.



You do not need to claim the combat zone exclusion on your tax return because this type of income is not included in the wages reported on your Form W-2. (See Form W-2, below.)

Hospitalized while serving in the combat zone. If you are hospitalized while serving in the combat zone, the wound, disease, or injury causing the hospitalization will be presumed to have been incurred while serving in the combat zone unless there is clear evidence to the contrary.

Example. You are hospitalized for a specific disease in a combat zone where you have been serving for 3 weeks, and the disease for which you are hospitalized has an incubation period of 2 to 4 weeks. The disease is presumed to have been incurred while you were serving in the combat zone. On the other hand, if the incubation period of the disease is one year, the disease would not have been incurred while you were serving in the combat zone.

Hospitalized after leaving the combat zone. In some cases, the wound, disease, or injury may have been incurred while you were serving in the combat zone, even though you were not hospitalized until after you left.

Example. You were hospitalized for a specific disease 3 weeks after you left the combat zone. The incubation period of the disease is from 2 to 4 weeks. The disease is presumed to have been incurred while serving in the combat zone.

Form W-2. The wages shown in box 1 of your 2003 Form W-2 should not include military pay excluded from your income under the combat zone exclusion provisions. If it does, you will need to get a corrected Form W-2 from your finance office.

You cannot exclude as combat pay any wages shown in box 1 of Form W-2.

Alien Status

For tax purposes, an alien is an individual who is not a U.S. citizen. An alien is in one of three categories: resident, nonresident, or dual-status. Placement in the correct category is crucial in determining what income to report and what forms to file.

Most members of the Armed Forces are U.S. citizens or resident aliens. However, if you have questions about your alien status or the alien status of your dependents or spouse, you should read the information in the following paragraphs and get Publication 519.

Under peacetime enlistment rules, you generally cannot enlist in the Armed Forces unless you are a citizen or have been legally admitted to the United States for permanent residence. If you are an alien enlistee in the Armed Forces, you are probably a resident alien. If, under an income tax treaty, you are considered a resident of a foreign country, see your base legal officer. Other aliens who are in the United States only because of military assignments and who have a home outside the United States are nonresident aliens. Guam and Puerto Rico have special rules.

Residents of those areas should contact their taxing authority with their questions.

Resident Aliens

You are considered a U.S. resident alien for tax purposes if you meet either the **green card test** or the **substantial presence test** for the calendar year (January 1 – December 31). These tests are explained in Publication 519. Generally, resident aliens are taxed on their worldwide income and file the same tax forms as U.S. citizens.

Treating nonresident alien spouse as resident alien. A nonresident alien spouse can be treated as a resident alien if **all** the following conditions are met.

- One spouse is a U.S. citizen or resident alien at the end of the tax year.
- That spouse is married to the nonresident alien at the end of the tax year.
- You both choose to treat the nonresident alien spouse as a resident alien.

Making the choice. Both you and your spouse must sign a statement and attach it to your joint return for the first tax year for which the choice applies. Include in the statement:

- A declaration that one spouse was a nonresident alien and the other was a U.S. citizen or resident alien on the last day of the year,
- A declaration that both spouses choose to be treated as U.S. residents for the entire tax year, and
- The name, address, and taxpayer identification number (social security number or individual taxpayer identification number) of each spouse. If the nonresident alien spouse is not eligible to get a social security number, he or she should file Form W-7, *Application for IRS Individual Taxpayer Identification Number (ITIN)*. ITINs may be available through the nearest overseas base legal office or U.S. consulate.



Once you make this choice, the nonresident alien spouse's worldwide income is subject to U.S. tax. If the nonresident alien spouse has substantial foreign income, there may be no advantage to making this choice.

Ending the choice. Once you make this choice, it applies to all later years unless one of the following situations occurs.

- You or your spouse revokes the choice.
- You or your spouse dies.
- You and your spouse become legally separated under a decree of divorce or separate maintenance.
- The Internal Revenue Service ends the choice because of inadequate records.

For specific details on these situations, get Publication 519.

If the choice is ended for any of these reasons, neither spouse can make the choice for any later year. This ap-

plies to a divorced individual who previously made the choice and later remarries.

Choice not made. If you and your nonresident alien spouse do not make this choice:

- You cannot file a joint return. You can file as married filing separately, or head of household if you qualify.
- You can claim an exemption for your nonresident alien spouse if he or she has no gross income for U.S. tax purposes and is not another taxpayer's dependent (see *Exemptions*, later).
- The nonresident alien spouse generally does not have to file a federal income tax return if he or she had no income from sources in the United States. If a return has to be filed, see the next discussion.
- The nonresident alien spouse is not eligible for the earned income credit if he or she has to file a return.

Nonresident Aliens

An alien who does not meet the requirements to be a resident alien, as discussed earlier, is a nonresident alien. If required to file a federal tax return, nonresident aliens must file either Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, or Form 1040NR-EZ, *U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents*. See the form instructions for information on who must file and filing status.

Nonresident aliens generally must pay tax on income from sources in the United States. A nonresident alien's income that is from conducting a trade or business in the United States is taxed at graduated U.S. tax rates. Other income from U.S. sources is taxed at a flat 30% (or lower treaty) rate. For example, dividends from a U.S. corporation paid to a nonresident alien generally are subject to a 30% (or lower treaty) rate.

Dual-Status Aliens

An alien may be both a nonresident and resident alien during the same tax year, usually the year of arrival or departure. Dual-status aliens are taxed on income from all sources for the part of the year they are resident aliens. Generally, they are taxed only on income from sources in the United States for the part of the year they are nonresident aliens.

Exemptions

Exemptions reduce your income before you figure your tax. There are two types of exemptions.

- Personal exemptions.
- Exemptions for dependents.

While both types of exemptions are worth the same amount, different rules apply to each.

You generally can claim one exemption for yourself. If you are married and file a joint return, you can claim your own exemption and one for your spouse. If you file a

separate return, you can claim the exemption for your spouse only if your spouse had no gross income and was not a dependent of another taxpayer. You also can claim one exemption for each person qualifying as your dependent who meets five specific tests.



You may be eligible to claim an exemption for a child, even if the child has been kidnapped. See Kidnapped child under Exemptions for Dependents in Publication 501.

For 2003, you generally can deduct \$3,050 for each exemption you claim for yourself, your spouse, and each person who qualifies as your dependent.

If another taxpayer can claim an exemption for you or your spouse, you cannot claim that exemption on your tax return. If you can claim an exemption for a dependent, that dependent cannot claim an exemption on his or her own tax return.

To claim an exemption for a dependent on your tax return, you must list either the social security number (SSN), individual taxpayer identification number (ITIN), or adoption taxpayer identification number (ATIN) for that person on your return.

For more information on exemptions, see Publication 501.



If you do not list the dependent's SSN, ITIN, or ATIN, the exemption may be disallowed.

Dependents

A **dependent** is a person, other than you or your spouse, who meets the dependency tests. You can claim a dependency exemption if **all five** of the following tests are met.

- 1) **Member of household or relationship test.** To meet this test, the person must either live with you for the entire year as a member of your household or be related to you in one of the ways listed under *Relatives who do not have to live with you* in Publication 501.
- 2) **Citizen or resident test.** To meet this test, the person must be a U.S. citizen or resident, or a resident of Canada or Mexico for some part of the calendar year in which your tax year begins. Children are usually citizens or residents of the country of their parents.

If you were a U.S. citizen when your child was born, the child may be a U.S. citizen although the other parent was a nonresident alien (see *Alien Status*, earlier) and the child was born in a foreign country.

You can claim your child's exemption if the child is a U.S. citizen and meets the other tests. It does not matter that the child lives abroad with the nonresident alien parent.

If you are a citizen of the United States and you legally adopt a child who is not a U.S. citizen or resident, you can claim the child's exemption if:

 - a) The other tests are met,
 - b) The child had your home as his or her main home for the year, and

- c) The child was a member of your household for the year.

Example. Sergeant John Smith is a U.S. citizen and has been in the U.S. Army for 16 years. He is stationed in Germany. He and his wife, a German citizen, have a 2-year old son who was born in Germany and who has dual citizenship (U.S. and Germany). Sergeant Smith's stepdaughter, a German citizen whom he has not adopted, also lives with them. Only his son can be considered a U.S. citizen for whom a dependency exemption can be claimed. His stepdaughter does not qualify as a U.S. citizen or resident.

- 3) **Joint return test.** Even if the other dependency tests are met, you generally are not allowed an exemption for your dependent if he or she files a joint return. However, the joint return test does not apply if a joint return is filed by your dependent and his or her spouse merely as a claim for refund and no tax liability would exist for either spouse on separate returns.
- 4) **Gross income test.** To meet the gross income test, the person must have gross income of less than \$3,050. This test does not apply if the person is your child and is either under age 19 at the end of the year, or under age 24 at the end of the year and a full-time student during 5 calendar months of the year.
- 5) **Support test.** To be considered your dependent, the person generally must receive more than half of his or her support from you during the year. To figure if you provided more than half the support of a person, you must first determine the total support provided from all sources for that person.

Total support includes amounts spent to provide food, lodging, clothing, education, medical and dental care, recreation, transportation, and similar necessities.

Generally, the amount of an item of support is the amount of the expense incurred to provide it. If the item is lodging, the amount of the item is the fair rental value.

Expenses that are not directly related to any one member of a household, such as the cost of food for the household, must be divided among the members of the household.

Divorced or separated parents. Different rules apply to the support test for children of divorced or separated parents. These rules are discussed in Publication 501.

Dependency allotments. You can authorize an allotment from your pay for the support of your dependents. The amount is considered as provided by you in figuring whether you provide more than half the dependent's support.

If an allotment is used to support persons other than those you name, you can claim exemptions for them if they otherwise qualify as your dependent.

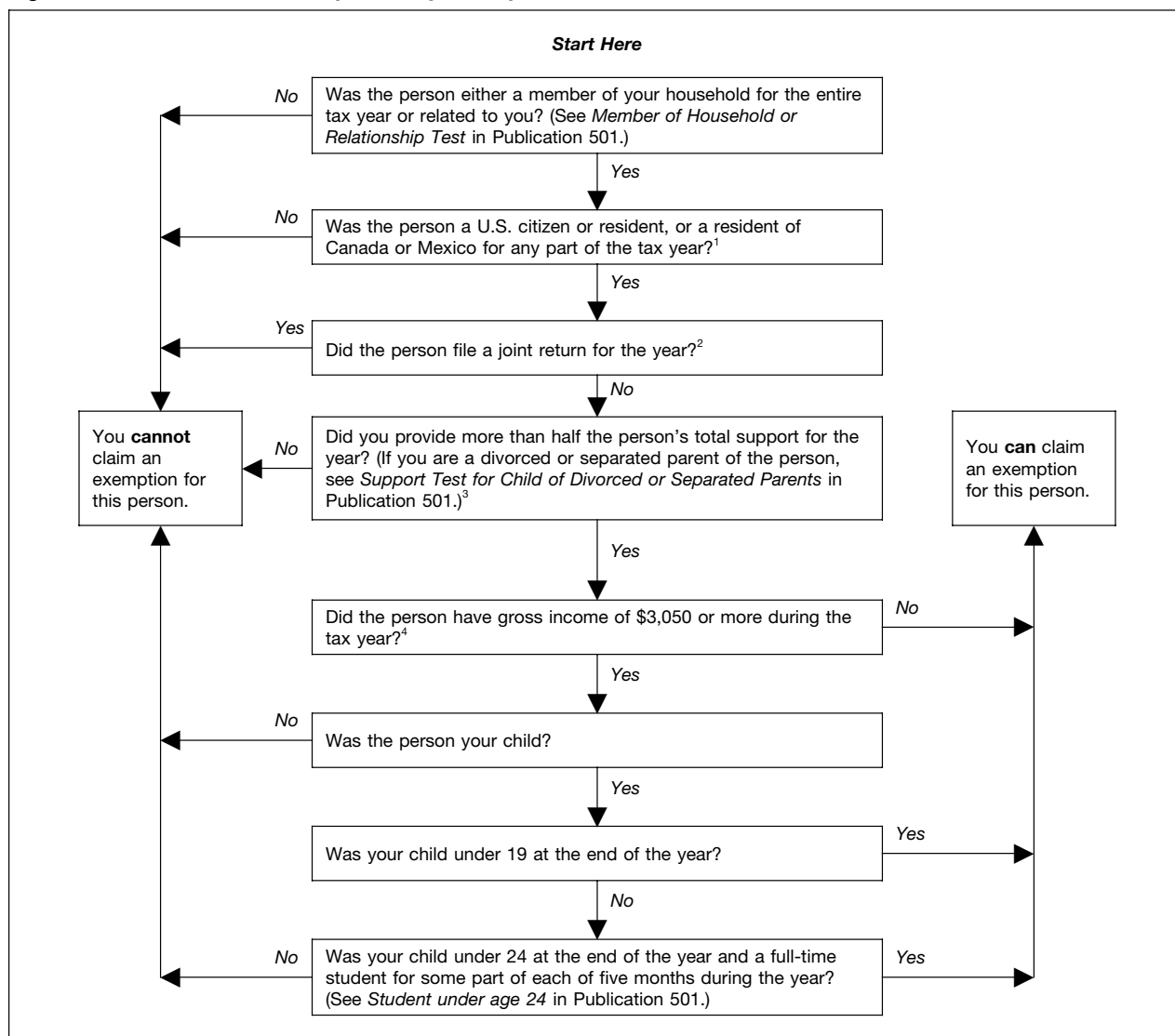
Example. Army Sergeant Jeff Banks authorizes an allotment for his widowed mother. She uses the money to support herself and Jeff's 10-year-old sister. If that amount

provides more than half their support, Jeff can claim an exemption for each of them, if they otherwise qualify, even though he only authorized the allotment for his mother.

Dependent in the Armed Forces. Generally, an exemption cannot be claimed for a person who is in the Armed Forces or is at one of the Armed Forces academies for the entire year because the support test will not have been met. However, if your dependent receives only partial support from the Armed Forces, you can still claim the exemption if you provided more than half his or her support and the other tests are met.

Example. Leslie James is 18 and single. She graduated from high school in June 2003 and entered the U.S. Air Force in September 2003. Leslie provided \$4,400 (her wages of \$3,400 and \$1,000 for other items provided by the Air Force) for her support that year. Her parents provided \$4,100. Her parents cannot claim a dependency exemption for her for 2003 because they did not provide more than half her support.

Figure A. **Can You Claim a Dependency Exemption?**



¹ If the person was your legally adopted child and lived in your home as a member of your household for the entire tax year, answer "yes" to this question.

² If neither the person nor the person's spouse is required to file a return but they file a joint return to claim a refund of tax withheld, you may answer "no" to this question.

³ Answer "yes" to this question if you meet the multiple support requirements under *Multiple Support Agreement* in Publication 501.

⁴ Gross income for this purpose does not include income received by a permanently disabled individual at a sheltered workshop. (See *Disabled dependents* in Publication 501.)

Sale of Home

Current tax rules that apply when you sell your main home differ from tax rules that applied when you sold your main home before May 7, 1997. Usually, your main home is the one in which you live most of the time. It can be a:

- House,
- Houseboat,
- Mobile home,
- Cooperative apartment, or
- Condominium.

See Publication 523 for more information.

Rules for Sales in 2003

You generally can exclude up to \$250,000 of gain (\$500,000, in most cases, if married filing a joint return) realized on the sale or exchange of a main home in 2003. The exclusion is allowed each time you sell or exchange a main home, but generally not more than once every 2 years. To be eligible, during the 5-year period ending on the date of the sale, you must have owned the home for at least 2 years (the ownership test), and lived in the home as your main home for at least 2 years (the use test).

Exception to ownership and use tests. You can exclude gain, but the maximum amount of gain you can exclude will be reduced if you do not meet the ownership and use tests due to a move to a new permanent duty station.

5-year test period suspended. You can choose to have the 5-year test period for ownership and use suspended during any period you or your spouse serve on **qualified official extended duty** as a member of the Armed Forces. This means that you may be able to meet the 2-year use test even if, because of your service, you did not actually live in your home for at least the required 2 years during the 5-year period ending on the date of sale.

Example. David bought and moved into a home in 1995. He lived in it as his main home for 2½ years. For the next 6 years, he did not live in it because he was on qualified official extended duty with the Army. He then sold the home at a gain in 2003. To meet the use test, David chooses to suspend the 5-year test period for the 6 years he was on qualifying official extended duty. This means he can disregard those 6 years. Therefore, David's 5-year test period consists of the 5 years before he went on qualifying official extended duty. He meets the ownership and use tests because he owned and lived in the home for 2½ years during this test period.

Period of suspension. The period of suspension cannot last more than 10 years. You cannot suspend the 5-year period for more than one property at a time. You can revoke your choice to suspend the 5-year period at any time.

Qualified official extended duty. You are on qualified official extended duty if you serve on extended duty either:

- At a duty station at least 50 miles from your main home, or
- While you live in Government quarters under Government orders.

You are on extended duty when you are called or ordered to active duty for a period of more than 90 days or for an indefinite period.

Claiming a refund for a prior-year home sale. This rule for suspending the 5-year period became law in 2003 but applies to any sale of a main home after May 6, 1997. Therefore, you may be entitled to claim a refund if this rule applies to you and you paid tax on a gain from the sale of a home after that date. If you are entitled to a refund, complete and file Form 1040X, *Amended U.S. Individual Income Tax Return*. At the top of Form 1040X, write "Military Family Tax Relief Act" in red.

Generally, you must file a claim for credit or refund within 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later. However, the deadline to file a claim based on this rule for 1997, 1998, 1999, or 2000 has been extended to November 10, 2004.

Property used for rental or business. You may be able to exclude your gain from the sale of a home that you have used as a rental property or for business. However, you must meet the ownership and use tests discussed in Publication 523.

Loss. You cannot deduct a loss from the sale of your main home.

More information. For more information on the laws affecting the sale of a home in 2003, see Publication 523.

Rules for Sales Before May 7, 1997

The rules in this section apply to you only if you sold your main home at a gain before May 7, 1997, and **all three** of the following statements are true.

- 1) You postponed the gain as described later.
- 2) The 2-year period you had to replace that home (your replacement period) was suspended while you served in the Armed Forces.
- 3) You have not already reported to the IRS either your purchase of a new home within your replacement period or a taxable gain resulting from the end of your replacement period, as described under *What To Report Now*, later.

Gain. If you had a gain from the sale, you had to include it in your income for the year of sale, except for any part you postponed or excluded.

Loss. If you had a loss from the sale, you could not deduct it.

Form 2119. Generally, sales covered by this section were reported using Form 2119. If the rules in this section apply to you, you may have to file a second Form 2119. See *What To Report Now*, later.

Rules That Provided for Postponing Gain

Under the rules of this section, you were **required** to postpone tax on the gain on the sale of your main home before May 7, 1997, if both of the following were true.

- 1) You bought and lived in a new main home before the end of the replacement period.
- 2) The new main home cost at least as much as the adjusted sales price of the old home.

Also, if you were age 55 or older on the date of sale and met certain other qualifications, no tax applied to any gain you chose to exclude (on line 14 of Form 2119).

This section explains the time allowed for replacing your main home (the replacement period) and how to determine the taxable gain, if any. The main topics in this section are:

- Replacement period,
- Old home,
- New home, and
- Certain sales by married persons.

Tax postponed, not forgiven. The tax on the gain is postponed, not forgiven. You subtract any gain that is not taxed in the year you sell your old home from the cost of your new home. This gives you a lower basis in the new home.

Example. You sold your home in February 1997 for \$90,000 and had a \$5,000 gain. You were a member of the Armed Forces stationed outside the United States until your return in 2003. In January 2003, within the time allowed for replacement, you bought another home for \$203,000 and moved into it. The \$5,000 gain was not taxed in 1997, but you must subtract it from the \$203,000. This makes the basis of your new home \$198,000. If you later sell the new home for \$210,000, your gain will be \$12,000 (\$210,000 – \$198,000).

Source of funds to buy home. You do not have to use the same funds received from the sale of your old home to buy or build your new home. For example, you can use less cash than you received by increasing the amount of your mortgage loan and still postpone the tax on your gain.

Replacement Period

Your replacement period is the time period during which you must replace your old home to postpone any of the gain from its sale. It starts **2 years before** and ends **2 years after** the date of sale unless the replacement period was suspended.

Example. You sold your old home on April 27, 1997. You had until April 27, 1999, to buy and move into a new home that you use as your main home, unless you qualified for a suspension of the replacement period.

Suspension of replacement period. The 2-year replacement period after the sale may still be suspended only for members of the Armed Forces stationed outside the United States.

If you are one of these individuals and sold a home before May 7, 1997, your replacement period may include all or part of 2003. For everyone else who sold a home before May 7, 1997, the replacement period ended before 2003.

Serving on extended active duty. The replacement period after the sale of your old home is suspended while you serve on extended active duty in the Armed Forces. You are on extended active duty if you are serving under a call or order for more than 90 days or for an indefinite period. The suspension applies only if your service begins before the end of the 2-year replacement period. The replacement period, plus any period of suspension, is limited to **4 years** after the date you sold your old home, unless you are stationed outside the United States.

Stationed outside the United States. The suspension of the replacement period after the sale of your old home is extended for up to an additional 4 years while you are:

- Stationed outside the United States, or
- Required to live in on-base quarters following your return from a tour of duty outside the United States. In this case, you must be stationed at a remote site where the Secretary of Defense has determined that adequate off-base housing is not available.

The suspension can continue for up to 1 year after the last day you are stationed outside the United States or the last day you are required to live in government quarters on base. However, the replacement period, plus any period of suspension, is limited to **8 years** after the date of sale of your old home.

Example. You are a regular member of the Armed Forces and sold your home on May 1, 1997. During the 4 years from April 1, 1997, to April 1, 2001, you served outside the United States. When you returned, you were stationed at a remote site and were required to live on base because off-base housing was not available. The time to replace your home was suspended:

- 1) While you were serving outside the United States, plus
- 2) While you were required to live on base after your return from the overseas assignment, plus
- 3) Up to 1 year.

The requirement that you live on base ended on October 31, 2002. The suspension period will expire October 31, 2003. You have less than the full 2-year replacement period to buy or build and occupy a new home. This is because your replacement period plus your 6½-year period of suspension is limited to 8 years after the sale of your old home. Therefore, your replacement period ends on April 1, 2005.

Spouse in Armed Forces. If your spouse is in the Armed Forces and you are not, the suspension also applies to you if you owned the old home. Both of you must have used the old home and must use the new home as your main home. However, if you are divorced or separated while the replacement period is suspended, the suspension ends for you on the date of the divorce or separation.

Combat zone service. The running of the replacement period (including any suspension) is suspended for any period you served in a combat zone. See *Combat Zone Exclusion*, earlier, for the definition of a combat zone and when service is considered to have been performed in a combat zone.

When suspension ends. This suspension ends 180 days after the later of:

- The last day you were in the combat zone (or, if earlier, the last day the area qualified as a combat zone), or
- The last day of any continuous hospitalization (limited to 5 years if hospitalized in the United States) for an injury received while serving in the combat zone.

Example. Sergeant James Smith, on extended active duty in an Army unit stationed in Virginia, had a gain from the sale of his home on April 4, 1997. He had not yet purchased a new home when he entered a combat zone on January 4, 1999. He left the combat zone on January 4, 2000, and returned with his unit to Virginia. He remains on active duty in Virginia.

Sergeant Smith's replacement period began on April 4, 1997, the date he sold the home.

When he entered the combat zone on January 4, 1999, Sergeant Smith had used 21 months of the replacement period. The replacement period was then suspended for the time he served in the combat zone plus 180 days. The replacement period started again on July 3, 2000, after the end of the 180-day period (January 5, 2000, to July 2, 2000) following his last day in the combat zone. Sergeant Smith then has 27 months remaining in his replacement period (4 years or 48 months minus the 21 months already used). His replacement period ends October 2, 2002 (27 months after July 2, 2000).

Spouse. The suspension for service in a combat zone generally applies to your spouse (even if you file separate returns). However, any suspension because of your hospitalization within the United States does not apply to your spouse. Also, the suspension for your spouse does not apply for any tax year beginning more than 2 years after the last day the area qualified as a combat zone.

Home not replaced within replacement period. If you do not replace the home in time and you had postponed gain in the year of sale, you must file an amended return for the year of sale. You must include in your income the entire gain on the sale of your old home. For details, see *What To Report Now*, later.

Occupancy test. You must physically live in the new home as your main home within the replacement period. If you move furniture or other personal belongings into the new home but do not actually live in it, you have not met the occupancy test.

No added time is allowed. To postpone gain on the sale of your home, you must replace the old home and occupy the new home within the specified period. You are not allowed any additional time, even if conditions beyond your control keep you from doing it. For example, destruction of the new home while it was being built would not extend the replacement period.

Old Home

To figure the taxable gain and postponed gain from the sale of your old home, compare the **adjusted sales price** of your old home with the cost of your new home, as shown in the following chart.

IF the cost of your new home is...	THEN you...
Equal to or more than the adjusted sales price of your old home	Must postpone your entire gain. None of it is taxed in the year of sale.
Less than the adjusted sales price of your old home	Are taxed on the smaller of: • The entire gain (minus any one-time exclusion), or • The difference between the adjusted sales price of the old home and the cost of the new home. You must postpone any gain that is not taxed.

Adjusted sales price. This is the amount realized from the sale of your old home minus:

- Any one-time exclusion you claimed (line 14 of Form 2119), and
- Any fixing-up expenses you had (line 16 of Form 2119).

If the amount realized (minus any one-time exclusion) is not more than the cost of your new home, you postpone your entire gain. You do not need to figure your fixing-up expenses.

Fixing-up expenses. Fixing-up expenses are decorating and repair costs that you paid to sell your old home. For example, the costs of painting the home, planting flowers, and replacing broken windows are fixing-up expenses. Fixing-up expenses must meet all the following conditions. The expenses:

- Must be for work done during the 90-day period ending on the day you sign the contract of sale with the buyer,
- Must be paid no later than 30 days after the date of sale,
- Cannot be deductible in arriving at your taxable income,
- Must not be used in figuring the amount realized, and
- Must not be capital expenditures or improvements.

Note. You subtract fixing-up expenses from the amount realized **only** in figuring the part of the gain that you postpone. You **cannot** use them in figuring the actual gain on the sale.

Example. Your old home had a basis of \$55,000. You signed a contract to sell it on December 17, 1996. On January 7, 1997, you sold it for \$71,400. Selling expenses were \$5,000. During the 90-day period ending December 17, 1996, you had the following work done. You paid for the work within 30 days after the date of sale.

Fixing-up expenses:	
Inside and outside painting	\$800
Improvements:	
New venetian blinds and new water heater	\$900

Within the replacement period, you bought and lived in a new home that cost \$64,600. You figure the gain postponed and not postponed, and the basis of your new home, as follows:

Gain On Sale	
a) Selling price of old home	\$71,400
b) Minus: Selling expenses	5,000
c) Amount realized on sale	\$66,400
d) Basis of old home	55,000
e) Plus: Improvements (blinds and heater)	900
f) Adjusted basis of old home	55,900
g) Gain on sale [(c) minus (f)]	10,500
Gain Taxed in Year of Sale	
h) Amount realized on sale	66,400
i) Minus: Fixing-up expenses (painting)	800
j) Adjusted sales price	65,600
k) Minus: Cost of new home	64,600
l) Excess of adjusted sales price over cost of new home	1,000
m) Gain taxed in year of sale [lesser of (g) or (l)]	1,000
Gain Postponed	
n) Gain on sale [line (g)]	10,500
o) Minus: Gain taxed [line (m)]	1,000
p) Gain postponed	9,500
Adjusted Basis of New Home	
q) Cost of new home [line (k)]	64,600
r) Minus: Gain postponed [line (p)]	9,500
s) Adjusted basis of new home	\$55,100

Property used partly as your home and partly for business or rental. You may use part of your property as your home and part of it for business or to produce income. If you sell the entire property, you should consider the transaction as the sale of two properties. You postpone the gain only on the part used as your home. This includes the land and outbuildings, such as a garage for the home, but not those used for the business or the production of income.

To postpone the gain on the part of the property that is your home (one property), you must reinvest an amount equal to that part's adjusted sales price in your new home. The same rule applies if you buy property for use as your home and for your business. Only the purchase price for the part used as your home can be counted as the cost of a new home. See *New home used partly for business or rental*, later.

For an example of how to divide the gain between the part of the property used as your home and the part used for business or other purposes, see *Business Use or Rental of Home* in Publication 523.

Home changed to rental property. You cannot postpone tax on the gain on rental property, even if you once used it as your home. The rules explained in this publication

generally will not apply to sale of rental property. Gains are taxable and losses are deductible as explained in Publication 544.

Temporary rental of home before sale. You have not changed your home to rental property if you temporarily rented your old home before selling it, or your new home before living in it, as a matter of convenience or for another nonbusiness purpose. You postpone the tax on the gain from the sale if you meet the requirements explained earlier.

For information on how to treat the rental income you receive, see Publication 527.

Failed attempt to rent home. If you placed your home with a real estate agent for rent or sale and it was **not** rented, it is not considered business property or property held for the production of income. The postponement of gain rules explained in this publication will apply to the sale.

New Home

Your new home must be your main home. See the explanation of **main home**, earlier.

You must include in income any gain from the sale of your old home if you replace it with property that is not your main home.

New home outside the United States. A new home outside the United States qualifies as a new home for purposes of postponing gain. You must buy or build and live in the new home as your main home within the time allowed for replacement.

Retirement home. You have not purchased a new home if you invest in a retirement home project that gives you living quarters and personal care but does not give you any legal interest in the property. Therefore, you must include in income any gain on the sale of your old home. However, if you were age 55 or older on the date of the sale, you may have been able to claim a one-time exclusion (line 14 of Form 2119).

Title to new home not held by you or spouse. You have not purchased a new home if you invest in a home in which neither you nor your spouse holds any legal interest (for example, a house to which someone else, such as your child, holds the title).

Holding period. If you postponed tax on any part of the gain from the sale of your old home, you will be considered to have owned your new home for the combined period you owned both the old and the new homes. This may affect how any taxable gain when you sell the new home is reported on Schedule D (Form 1040).

How To Figure Cost of New Home

You need to know the cost of your new home to figure the gain taxed and the gain on which tax is postponed on the sale of your old home. The cost of your new home includes costs incurred during the replacement period for the following items:

- Buying or building the home,
- Rebuilding the home, and

- Capital additions or improvements.

You cannot consider any costs incurred before or after the replacement period. However, you can include any costs incurred during the suspension period (discussed under *Replacement Period*, earlier).

Debts on new home. The cost of a new home includes the debts it is subject to when you buy it (purchase-money mortgage or deed of trust) and the face amount of notes or other liabilities you give for it.

Temporary housing. If a builder gives you temporary housing while your new home is being finished, you must reduce the contract price to arrive at the cost of the new home. To figure the amount of the reduction, multiply the contract price by a fraction. The numerator (top number) is the value of the temporary housing, and the denominator (bottom number) is the sum of the value of the temporary housing plus the value of the new home.

Seller-paid points. In figuring the cost of your new home, you must subtract any points paid by the seller from your purchase price.

Settlement fees or closing costs. The cost of your new home includes the settlement fees and closing costs that you can include in your basis. See *Settlement fees or closing costs* under *Basis*, in Publication 523.

Settlement fees do not include amounts placed in escrow for the future payment of items such as taxes and insurance.

Real estate taxes. If you agreed to pay taxes the seller owed on your new home (that is, taxes up to the date of sale), the taxes you paid are treated as part of the cost. For more information, see *Real Estate and Transfer Taxes* in Publication 523.

New home used partly for business or rental. If you replace your old home with property used partly as your home and partly for business or rental, you consider only the cost of the part used as your home. You must compare the cost of this part to the adjusted sales price of the old home to determine the amount of gain taxed in the year of sale and the amount of gain on which tax is postponed.

Example. Your old home had a basis of \$50,000. You sold it in February 1997 for a gain of \$25,000. Your adjusted sales price is \$75,000. Before your replacement period ended, you bought a duplex house for \$120,000. You live in half and rent the other half. Only half of the cost of the duplex (\$60,000) is considered an investment in a new main home, so you are taxed on \$15,000 (\$75,000 adjusted sales price – \$60,000 cost) of the \$25,000 gain on the sale. You must postpone tax on \$10,000 of the gain reinvested in your new home. The basis of your new home is \$50,000 (\$60,000 cost – \$10,000 postponed gain). The basis of the rented part of the duplex is \$60,000.

Inheritance or gift. If you receive any part of your new home as a gift or an inheritance, you cannot include the value of that part in the cost of the new home when figuring the gain taxed in the year of sale and the gain on which tax is postponed. However, you include the basis of that part in your adjusted basis to determine any gain when you sell the new home.

Example. You bought a home in 1992 for \$60,000. You sold that home in March 1997 for \$65,000, at a gain of \$5,000. You had fixing-up expenses of \$200.

Later, your father died and you inherited his home. Its basis to you is \$62,000. You spent \$14,000 to modernize the home, resulting in an adjusted basis to you of \$76,000. You moved into the home before your replacement period ended.

To find the gain taxed in the year of the sale, you compare the adjusted sales price of the old home, \$64,800 (\$65,000 – \$200), with the \$14,000 you invested in your new home. (For this purpose, you do not include the value of the inherited part of your property, \$62,000, in the cost of your new home.) The \$5,000 gain is fully taxed because the adjusted sales price of the old home is more than the amount you paid to remodel your new home, and the difference between the two amounts is more than \$5,000.

Certain Sales by Married Persons

This section explains how married persons figure their postponed gain in certain situations.

You may be able to postpone gain from the sale of your old home even if:

- You or your spouse owned the old home separately, but title to the new one is in both your names as joint tenants, or
- You and your spouse owned the old home as joint tenants, and either you or your spouse owns the new home separately.

You and your spouse can figure the postponed gain, which reduces the basis of the new home, as if the two of you owned both homes jointly. To do this, both of you must meet both of the following requirements.

- You used the old home as your main home and you use the new home as your main home.
- You sign a statement that says: “We agree to reduce the basis of the new home by the gain from selling the old home.”

Both of you must sign the statement. You can make the statement in the bottom margin on page 1 of Form 2119 or on an attached sheet. If either of you does not sign the statement, you must report the gain in the regular way, as explained in the following example.

Example. In April 1997, you sold a home that you owned separately but that both you and your spouse used as your main home. The adjusted sales price was \$98,000, the adjusted basis was \$86,000, and the gain on the sale was \$12,000. Before the replacement period ends, you and your spouse buy a new home for \$100,000. You move in immediately. The title is held jointly, and under state law, you each have a one-half interest. If you both sign the statement to reduce the basis of the new home, you postpone the gain on the sale as if you had owned both the old and new homes jointly. You and your spouse will each have an adjusted basis of \$44,000 (\$50,000 cost minus \$6,000 postponed gain) in the new home.

If either of you does not sign the statement, your entire gain of \$12,000 will be currently taxed, not postponed. This is because the adjusted sales price of the old home

(\$98,000) is greater than your part of the cost of the new home (\$50,000). You and your spouse will each have a basis of \$50,000 in the new home.

Deceased spouse. If your spouse died after you sold your old home and before you bought and occupied a new home, you can postpone the gain from the sale of the old home if the basic requirements are met, and:

- You were married on the date your spouse died, and
- You use the new home as your main home.

This applies whether title to the old home was in one spouse's name or held jointly.

Separate homes replaced by single home. If you and your spouse both had gains from the sales of homes that had been your separate main homes before your marriage, you may have to postpone the tax on both gains. This can happen if all of the following are true.

- You jointly purchase a new home.
- Each spouse's share of the cost of the new home is at least as much as the adjusted selling price of that spouse's old home. (Each spouse's share of the cost of the new home is the part equal to his or her interest in the home under state law, generally one-half.)
- Each spouse occupies the new home within the replacement period.

Home replaced by two homes of spouses living apart. If you and your spouse sell a jointly-owned home and each of you then buys and lives in separate new homes, the postponement provisions apply separately to your gain and to your spouse's gain.

You report the sale of your home as if two separate properties were sold. You each report half of the sales price.

Only one spouse buys a new home. Even if your spouse does not buy a new home within the replacement period, you still should report only your share of any gain from the sale of the old home. You postpone your share of the gain if you meet all the requirements to do so, even though your spouse cannot postpone his or her share.

If you and your spouse originally filed a joint return for the year of sale, you and your spouse must file an amended joint return to report your spouse's share of the gain, which cannot be postponed. See *Divorce after sale*, under *What To Report Now*, later.

What To Report Now

If the rules for sales before May 7, 1997, apply to you, the reporting requirements you may have are explained here.

Form 2119. For sales before 1998, Form 2119 was used to report the sale of an old home and any purchase of a new one within the replacement period. You should have filed Form 2119 with your tax return for the year you sold your old home. If you filed your return for that year before buying a new home, you also may have to file a second Form 2119 when you do buy your new home. If you need

Form 2119 for that purpose, you still can order it from the IRS. See *How to Get Tax Help*, later.



Recordkeeping. Keep a copy of Form 2119 with your tax records for the year of the sale. Form 2119 is also a supporting document that shows how your new home's basis is decreased by the amount of any postponed gain on the sale of your old home. Therefore, you also should keep a copy of Form 2119 with your records for the basis of your new home.

Loss reported on sale. If you reported a loss on the sale of your home, do not file a second Form 2119 if you later buy a new home. The loss on the sale was not deductible and has no effect on the basis of your new home.

Reporting a taxable gain. Any taxable gain on the sale is reported on Schedule D (Form 1040).

New home purchased after return filed. If you postponed gain from the sale of your old home and you buy and live in a new home after you file your return for the year of the sale but within the replacement period, you should notify the IRS by filing a second Form 2119 and, if necessary, Form 1040X and Schedule D.

Send the form (or forms) to the Internal Revenue Service Center where you will file your next tax return.

New home costs at least as much as adjusted sales price. If your new home costs at least as much as the adjusted sales price of your old home, file the second Form 2119 by itself. This form must include your address, signature, and the date. If you filed a joint return for the year of sale, the form also must include your spouse's signature.

New home costs less. If your new home costs less than the adjusted sales price of the old home, you must file an amended return (Form 1040X) for the year of sale. Attach a second completed Form 2119 to report the purchase and Schedule D (Form 1040) showing the gain you must report. You will have to pay interest on any additional tax due. The interest generally is figured from the due date of the original return.

No new home within replacement period. If you postponed gain on the sale of your old home because you planned to replace it but you do not replace it within the replacement period, you must file a second Form 2119. Attach it to your amended return (Form 1040X) for the year of the sale. Include a Schedule D (Form 1040) to report your gain.

You will have to pay interest on the additional tax due. Interest generally is figured from the due date of the original return.

Divorce after sale. If you are divorced after filing a joint return on which you postponed the gain on the sale of your home, but you do not buy or build a new home (and your former spouse does), you must file an amended joint return to report the tax on your share of the gain. If your former spouse refuses to sign the amended joint return, attach a letter explaining why your former spouse's signature is missing.

Statute of limitations. The 3-year limit for assessing tax on the gain from the sale of your home begins when you give the IRS information that shows:

- You replaced your old home, and how much the new home cost,
- You do not plan to buy and occupy a new home within the replacement period, **or**
- You did not buy and occupy a new home within the replacement period.

This information may be on the Form 2119 attached to your tax return for the year of the sale, or on a second Form 2119 filed later. File the second Form 2119 with the IRS where you file your next tax return. If needed, send an amended return for the year of the sale to include in income the gain that you cannot postpone.

Example. Frank and Evelyn Smith sold their home on May 1, 1997, for \$87,000. They spent \$500 on fixing-up expenses and paid a commission on the sale of \$5,200. Neither Frank nor Evelyn was 55 or older on the date of the sale. They planned to buy a replacement home but had not bought one before they filed their 1997 tax return.

Frank and Evelyn completed Part 1 of Form 2119 and attached it to their 1997 return. They planned to buy a replacement home, so they did not include the gain on the sale in the income reported on their return.

Frank and Evelyn's replacement period for purchasing a new home was suspended for 4 years while Frank was outside the United States on extended active duty with the Armed Forces.

On April 20, 2003, (within the extended replacement period), Frank and Evelyn bought and moved into a new home. The cost of the new home was \$77,200. This was less than the adjusted sales price of the old home. They figure the gain, the part of the gain on which tax is postponed and the part on which it is not, and the adjusted basis of their new home in the following way:

Gain On Sale

a) Selling price of old home	\$87,000	
b) Minus: Selling expenses	5,200	
c) Amount realized on sale		\$81,800
d) Minus: Adjusted basis of old home . . .		63,000
e) Gain on sale		<u>18,800</u>

Gain Taxed in 1997

f) Amount realized on sale	81,800	
g) Minus: Fixing-up expenses	500	
h) Adjusted sales price		81,300
i) Minus: Cost of new home		77,200
j) Excess of adjusted sales price over cost of new home		4,100
k) Gain taxed in 1997 [lesser of (e) or (j)]		<u>4,100</u>

Gain Not Taxed in 1997

l) Gain on sale [line (e)]	18,800	
m) Minus: Gain taxed in 1997 [line (k)]	4,100	
n) Gain not taxed in 1997		<u>14,700</u>

Adjusted Basis of New Home

o) Cost of new home [line (i)]	77,200	
p) Minus: Gain not taxed in 1997 [line (n)]	14,700	
q) Adjusted basis of new home		<u>\$62,500</u>

The Smiths file Form 1040X to amend their 1997 return to include in income the part of their gain on which tax is not postponed. They attach a second Form 2119 and a Schedule D (Form 1040) that includes the taxable part of the gain.

Itemized Deductions

To figure your taxable income, you must subtract either your standard deduction or your itemized deductions from adjusted gross income. For information on the standard deduction, get Publication 501.

Itemized deductions are figured on Schedule A (Form 1040). This chapter discusses itemized deductions of particular interest to members of the Armed Forces. For information on other itemized deductions, get the publications listed below.

- Publication 502, *Medical and Dental Expenses*
- Publication 526, *Charitable Contributions*
- Publication 547, *Casualties, Disasters, and Thefts*
- Publication 550, *Investment Income and Expenses*

Miscellaneous Itemized Deductions

You must reduce the total of most miscellaneous itemized deductions by 2% of your adjusted gross income. For information on deductions that are not subject to the 2% limit, get Publication 529.

Employee Business Expenses

Deductible employee business expenses are miscellaneous itemized deductions subject to the 2% limit. For information on employee business expenses, get Publication 463.

Generally, you must file Form 2106, *Employee Business Expenses*, or Form 2106-EZ, *Unreimbursed Employee Business Expenses*, to claim these expenses. You do not have to file Form 2106 or Form 2106-EZ if you are claiming only unreimbursed expenses for uniforms, professional society dues, and work-related educational expenses (all discussed later). You can deduct these expenses directly on Schedule A (Form 1040).

Reimbursement. Generally, to receive advances, reimbursements, or other allowances from the government, you must adequately account for your expenses and return any excess reimbursement. Amounts that are not excess reimbursements that you receive under an accountable plan are not included on your Form W-2. Your reimbursed expenses are not deductible.

If your expenses are more than your reimbursement, the excess expenses are deductible (subject to the 2% limit) if you can prove them. You must file Form 2106 to report these expenses.

You can use the shorter Form 2106-EZ if you meet **all three** of the following conditions.

- You are an employee deducting expenses related to your job.
- You were not reimbursed by your employer for your expenses (amounts included in box 1 of your Form W-2 are not considered reimbursements).
- If you claim car expenses, you use the standard mileage rate.



For 2003, the standard mileage rate is 36 cents a mile for all business miles driven. This rate is adjusted periodically.

Travel expenses. You can deduct unreimbursed travel expenses only if they are incurred while you are traveling away from home. If you are a member of the U.S. Armed Forces on a permanent duty assignment overseas, you are not traveling away from home. You cannot deduct your expenses for meals and lodging while at your permanent duty station. You cannot deduct these expenses even if you have to maintain a home in the United States for your family members who are not allowed to accompany you overseas. (A naval officer assigned to permanent duty aboard a ship that has regular eating and living facilities has a tax home aboard ship for travel expense purposes.)

To be deductible, your travel expenses must be work related. You cannot deduct any expenses for personal travel, such as visits to family while on furlough, leave, or liberty.

Away from home. Home is your permanent duty station (which can be a ship or base), regardless of where you or your family live. You are away from home if you are away from your permanent duty station substantially longer than an ordinary day's work and you need to get sleep or rest to meet the demands of your work while away from home.

Examples of deductible travel expenses include:

- Expenses for business-related meals (generally limited to 50% of your unreimbursed cost), lodging, taxicabs, business telephone calls, tips, laundry, and dry cleaning while you are away from home on temporary duty or temporary additional duty, and
- Expenses of carrying out official business while on **No Cost** orders.



You cannot deduct any expenses for travel away from home if the temporary assignment in a single location is realistically expected to last (and does in fact last) for more than 1 year. This rule may not apply if you are participating in a federal crime investigation or prosecution. For more information, see Publication 463 and the Form 2106 instructions.

Transportation expenses. Transportation expenses are the ordinary and necessary costs you have to get from one workplace to another while not traveling away from home and for certain other business-related transportation. These expenses include the costs of transportation by air, bus, rail, taxi, and driving and maintaining your car. Transportation expenses incurred while traveling away from home are travel expenses. However, if you use your car while traveling away from home overnight, see the rules in chapter 4 of Publication 463 to figure your car expense deduction.

If you must go from one workplace to another while on duty (for example, as a courier or to attend meetings) without being away from home, your unreimbursed transportation expenses are deductible. However, the expenses of getting to and from your regular place of work (commuting) are not deductible.

Temporary work location. If you have one or more regular places of business away from your home and you commute to a temporary work location in the same trade or business, you can deduct the expenses of the daily round-trip transportation between your home and the temporary location.

Generally, if your employment at a work location is realistically expected to last (and does in fact last) for 1 year or less, the employment is temporary.

If your employment at a work location is realistically expected to last for more than 1 year or if there is no realistic expectation that the employment will last for 1 year or less, the employment is not temporary, regardless of whether it actually lasts for more than 1 year. If employment at a work location initially is realistically expected to last for 1 year or less, but at some later date the employment is realistically expected to last more than 1 year, that employment will be treated as temporary (unless there are facts and circumstances that would indicate otherwise) until your expectation changes.



*If you do **not** have a regular place of business, but you ordinarily work in the metropolitan area where you live, you can deduct daily transportation expenses between your home and a temporary work site outside your metropolitan area. However, you cannot deduct daily transportation costs between your home and temporary work sites within your metropolitan area. These are nondeductible commuting costs.*

Armed Forces reservists. A meeting of an Armed Forces reserve unit is a second place of business if the meeting is held on a day on which you work at your regular job. You can deduct the expense of getting from one workplace to the other. You usually cannot deduct the expense if the reserve meeting is held on a day on which you do not work at your regular job. In this case, your transportation generally is a nondeductible commuting expense. However, you can deduct your transportation expenses if the location of the meeting is temporary and you have one or more regular places of work.

If you ordinarily work in a particular metropolitan area but not at any specific location and the reserve meeting is held at a temporary location outside that metropolitan area, you can deduct your transportation expenses. If you travel away from home overnight to attend a guard or reserve meeting, you can deduct your travel expenses. See *Armed Forces Reservists* under *Adjustments to Income*, earlier.

Uniforms. You usually cannot deduct the expenses for uniform cost and upkeep. Generally, you must wear uniforms when on duty and you are allowed to wear them when off duty.

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

Expenses for the cost and upkeep of the following articles are deductible.

- Military battle dress uniforms and utility uniforms if you cannot wear them off duty.
- Articles not replacing regular clothing, including insignia of rank, corps devices, epaulets, aiguillettes, and swords.

- Reservists' uniforms if you can wear the uniform only while performing duties as a reservist.

Professional dues. You can deduct dues paid to professional societies directly related to your military position. However, you cannot deduct amounts paid to an officers' club or a noncommissioned officers' club.

Example. Lieutenant Margaret Allen, an electrical engineer at Maxwell Air Force Base, can deduct professional dues paid to the American Society of Electrical Engineers.

Educational expenses. You can deduct work-related educational expenses if they meet certain rules.

Qualifications. You can deduct the costs of qualifying education. This is education that meets at least one of the following two tests.

- 1) The education is required by your employer or the law to keep your present salary, status, or job. The required education must serve a bona fide business purpose of your employer.
- 2) The education maintains or improves skills needed in your present work.

However, even if the education meets one or both of the above tests, it is not qualifying education if it:

- Is needed to meet the **minimum educational requirements** of your present trade or business, or
- Is part of a program of study that will **qualify you for a new trade or business**.

You can deduct the expenses for qualifying education even if the education could lead to a degree.

Example 1. Lieutenant Colonel Mason has a degree in financial management and is in charge of base finances at her post of duty. She took an advanced finance course. She already meets the minimum qualifications for her job. By taking the course, she is improving skills in her current position. The course does not qualify her for a new trade or business. She can deduct educational expenses that are more than the educational allowance she received.

Example 2. Major Williams worked in the military base legal office as a legal intern. He was placed in **excess leave status** by his employer to attend law school. He paid all his educational expenses and was not reimbursed. After obtaining his law degree, he passed the state bar exam and worked as a judge advocate. His educational expenses are not deductible because the law degree qualified him for a new trade or business, even though the education maintained and improved his skills in his work.

Travel expenses. You cannot deduct the cost of travel that is itself a form of education, even if it is directly related to your duties in your work or business. However, if your educational expenses qualify as a deduction, travel for that education, including transportation, meals (subject to the 50% limit), and lodging, can be deducted. Educational services provided in kind, such as base-provided transportation to or from class, are not deductible.

If you need more information on educational expenses, get Publication 970.

Credits

After you have figured your taxable income and tax liability, you can determine if you are entitled to any tax credits. Most tax credits do not have special rules for members of the Armed Forces. However, the earned income credit and the child tax credit may be of interest to you.

Earned Income Credit

The earned income credit (EIC) is a special credit for certain persons who work. The credit reduces the amount of tax you owe (if any). It may also give you a refund.



If you claim the EIC and it is later disallowed, you may have to complete an additional form if you want to claim the credit in a following year. See chapter 5 in Publication 596 for more information, including how to claim the EIC after disallowance.

Persons With a Qualifying Child

If you have a qualifying child, you must meet all the following rules to claim the earned income credit.

- 1) You must have earned income during 2003.
- 2) Your earned income and adjusted gross income (AGI) must each be less than:
 - a) \$33,692 (\$34,692 for married filing jointly) if you have two or more qualifying children, or
 - b) \$29,666 (\$30,666 for married filing jointly) if you have one qualifying child.
- 3) Your filing status cannot be married filing separately.
- 4) You (or your spouse, if filing a joint return) cannot be a qualifying child of another person.
- 5) Your qualifying child cannot be used by more than one person to claim the credit. See *Qualifying child of more than one person*, later.
- 6) You cannot file Form 2555, *Foreign Earned Income*, or Form 2555-EZ, *Foreign Earned Income Exclusion*, to exclude income earned in foreign countries, or to deduct or exclude a foreign housing amount. See Publication 54 for more information about these forms.
- 7) You must be a U.S. citizen or resident all year unless:
 - a) You are married to a U.S. citizen or a resident alien, and
 - b) You choose to be treated as a resident alien for the entire year. If you need more information about making this choice, see *Resident Aliens*, earlier.
- 8) Your investment income must be \$2,600 or less during the year. For most people, investment income is taxable interest and dividends, tax-exempt interest, and capital gain net income.

- 9) You must have a valid social security number for yourself, your spouse (if filing a joint return), and any qualifying child.

Qualifying child of more than one person. Sometimes, a child meets the rules to be a qualifying child of more than one person. However, only one person can treat that child as a qualifying child and claim the EIC using that child. The paragraphs that follow will help you decide who can claim the EIC when more than one person has the same qualifying child.

You can choose which person will claim the EIC. If you and someone else have the same qualifying child, you and the other person(s) can decide who will claim the credit using that qualifying child. However, if you and the other person(s) cannot agree and more than one person claims the credit using the same child, the **tie-breaker rule** (explained in the next paragraph) applies. If the other person is your spouse and you file a joint return, this rule does not apply.

Tie-breaker rule. Under the tie-breaker rule, the child will be treated as a qualifying child only by:

- 1) The parent, if only one of the persons is the child's parent.
- 2) The parent with whom the child lived for the longest period of time during the year, if two of the persons are parents of the child and they do not file a joint return together.
- 3) The parent with the highest AGI if the child lived with each parent for the same amount of time during the tax year, and they do not file a joint return together.
- 4) The person with the highest AGI, if none of the persons is the child's parent.

Adjusted gross income (AGI). AGI is the amount on line 35 of Form 1040, or line 21 of Form 1040A.

If another person claims the EIC using this child. If your qualifying child is treated under this rule as the qualifying child of another person for 2003, you cannot take the EIC using this qualifying child.

See *Rule 9* in Publication 596 for more help in determining whether you can claim the EIC when you and someone else have the same qualifying child.

Qualifying child of another person. If you are a qualifying child of another person, you cannot claim the credit—no matter how many qualifying children you have.

How to report. If you meet all these rules, fill out Schedule EIC and attach it to either Form 1040 or Form 1040A. Also, complete the worksheet in the instructions for Form 1040 or Form 1040A to figure the amount of your credit. If you have a qualifying child, you cannot claim the credit on Form 1040EZ.

Enter "NO" directly to the right of line 63 (Form 1040) or line 41 (Form 1040A) if you cannot claim the credit because:

- Your earned income was \$29,666 (\$30,666 for married filing jointly) or more if you have one qualifying child, or \$33,692 (\$34,692 for married filing jointly) or more if you have more than one qualifying child,

- You (or your spouse, if filing a joint return) were a qualifying child for another person in 2003,
- Another person is entitled to claim the EIC using your qualifying child (as explained under *Qualifying child of more than one person*, earlier), or
- You, your spouse, or your qualifying child does not have a valid social security number.

Social security number. You must provide a correct and valid social security number (SSN) issued by the Social Security Administration for yourself, your spouse, and any qualifying child. If a social security card for you, your spouse, or your qualifying child says "Not valid for employment" and the SSN was issued only so that you (or your spouse or child) could get a federally funded benefit, you cannot get the credit.

If you need to get an SSN, file Form SS-5 with your local Social Security Administration office. It takes approximately 2 weeks to receive an SSN. If the filing deadline is approaching and you do not have an SSN, you can:

- Request an automatic extension to August 15 using Form 4868, or
- File the return on time without claiming the credit. After you receive the SSN, file an amended return (Form 1040X) claiming the credit (and attach a filled-in Schedule EIC if needed).



If an SSN for you, your spouse, or your qualifying child is missing from your tax return, or is incorrect, you may not get the credit.

Married persons. Married persons usually must file a joint return to claim the earned income credit. Your filing status cannot be "married filing separately."

Even though you are married, you may be able to file as head of household (instead of married filing separately) and claim the credit on your return if your spouse did not live in your home at any time during the last 6 months of the year. For details about claiming head of household filing status, see Publication 501.

Qualifying Child

You have a qualifying child if your child meets three tests:

- 1) Relationship,
- 2) Residency, and
- 3) Age.

Relationship test. To meet the relationship test, the child must be your:

- Son, daughter, stepson, stepdaughter, or adopted child (or a descendant of your son, daughter, stepson, stepdaughter, or adopted child—for example, your grandchild),
- Brother, sister, stepbrother, or stepsister (or the child or grandchild of your brother, sister, stepbrother, or stepsister) whom you cared for as you would your own child, or

- Eligible foster child.

Adopted child. A child you legally adopt or who is placed with you by an authorized placement agency for adoption is treated the same as your child by blood.

Married child. Generally, a married child can be your qualifying child only if you can claim an exemption for the child. If you cannot claim an exemption for your married child, he or she still can be your qualifying child if the only reason you cannot claim the exemption is one of the following.

- You gave the right to claim the child's exemption to your child's other parent by signing Form 8332, or a similar written statement, or
- You gave the right to claim the child's exemption to your child's other parent in a pre-1985 agreement (such as a separation agreement or divorce decree).

If you need more information about either of these exceptions or when you can claim an exemption for your child, see Publication 501 or Publication 504, *Divorced or Separated Individuals*.

Residency test. To meet the residency test:

- A qualifying child must have lived in your home for more than half the year, and
- The home must be in the United States. (U.S. military personnel stationed outside the United States on extended active duty are considered to be living in the United States.)

Birth or death of a child. The child is considered to have lived with you for all of 2003 if:

- The child was born or died during the year, and
- The child lived with you for the part of the year he or she was alive.

Temporary absences. Count time that you or the qualifying child is away from home on a temporary absence due to a special circumstance as time lived at home. Examples of special circumstances include:

- Illness,
- Attending school,
- Detention in a juvenile facility,
- Business,
- Vacation, and
- Military service.

You may be eligible for the earned income credit if you are absent temporarily only because of military service. To be eligible for the credit, you must plan to return to your main home where your qualifying child lives, at the end of your assignment. Service in a combat zone is a temporary absence.

Age test. The age test is met if your child is:

- Under age 19 at the end of the year,

- A full-time student under age 24 at the end of the year, or
- Permanently and totally disabled at any time during the tax year, regardless of age.

Persons Without a Qualifying Child

If you do not have a qualifying child, you can take the credit if you meet **all** the following rules.

- 1) You must have earned income during 2003.
- 2) Your earned income and adjusted gross income must each be less than \$11,230 (\$12,230 for married filing jointly).
- 3) Your filing status cannot be **married filing separately**.
- 4) You (or your spouse, if filing a joint return) cannot be a qualifying child of another person. See *Qualifying child of another person*, earlier.
- 5) You (or your spouse if filing a joint return) must be at least age 25 but under age 65 at the end of your tax year.
- 6) You (or your spouse, if filing a joint return) cannot be claimed as a dependent by anyone else on that person's return.
- 7) Your main home must be in the United States for more than half the year. (U.S. military personnel stationed outside the United States on extended active duty are considered to live in the United States.)
- 8) You cannot file Form 2555, *Foreign Earned Income*, or Form 2555-EZ, *Foreign Earned Income Exclusion*.
- 9) You must be a U.S. citizen or resident alien all year unless:
 - a) You are married to a U.S. citizen or a resident alien, and
 - b) You choose to be treated as a resident alien for the entire year.
- 10) Your investment income must be \$2,600 or less during the year. For most people, investment income is taxable interest and dividends, tax-exempt interest, and capital gain net income.
- 11) You (and your spouse, if filing a joint return) must have a valid SSN. In either case, you can use only a valid SSN issued by the Social Security Administration. If a social security card for you or your spouse says, "Not valid for employment" and the SSN was issued only so that you or your spouse could get a federally funded benefit, you cannot get the credit.

How to report. If you meet all of these rules, fill out the EIC worksheet in your tax forms instructions to figure the amount of your credit.

Enter "No" directly to the right of line 63 (Form 1040), next to line 41 (Form 1040A), or on line 8 (Form 1040EZ) if you cannot claim the credit because:

- Your earned income was \$11,230 (\$12,230 for married filing jointly) or more,
- You (and your spouse, if filing a joint return) were under age 25 or age 65 or more,
- Your home was not in the United States for more than half the year,
- You (or your spouse, if filing a joint return) were a qualifying child of another person in 2003, or
- You (or your spouse, if filing a joint return) did not have a valid SSN.

Earned Income

For purposes of the earned income credit, earned income includes:

- Wages, salaries, and tips,
- Net earnings from self-employment, and
- Gross income received as a statutory employee.

For purposes of the earned income credit, earned income does **not** include:

- Basic pay or special, bonus, or other incentive pay that is subject to the combat zone exclusion,
- Basic Allowance for Housing (BAH),
- Basic Allowance for Subsistence (BAS),
- Any other nontaxable employee compensation,
- Interest and dividends,
- Social security and railroad retirement payments,
- Certain workfare payments,
- Pensions or annuities,
- Veterans' benefits (including VA rehabilitation payments),
- Workers' compensation,
- Unemployment compensation, or
- Alimony and child support.

IRS Will Figure Your Credit for You

There are certain instructions you must follow before the IRS can figure the credit for you. See Publication 967, *The IRS Will Figure Your Tax*.

Advance Earned Income Credit

You must meet all the following rules to qualify for the advance earned income credit in 2004. You must meet all of the following requirements.

- You must work and expect that your earned income and AGI will each be less than a certain amount. The amount in 2003 was \$29,666 (\$30,666 for married filing jointly). The amount for 2004 will be higher.

See the 2004 Form W-5, *Earned Income Credit Advance Payment Certificate*, for the 2004 amount.

- You must have a qualifying child.
- You must meet all the rules explained in the instructions for Form W-5.

If you expect to qualify for the earned income credit for 2004, you can choose to get part of the credit in advance by giving a completed 2004 Form W-5 to your appropriate finance office. The credit will be included regularly in your pay.

If you received advance earned income credit payments in 2003, you must file either Form 1040 or Form 1040A for 2003 to report the payments.

Child Tax Credit

The child tax credit reduces your tax. If you have children, you may be able to take a child tax credit on your tax return for each of your qualifying children.



*The child tax credit is **not** the same as the credit for child and dependent care expenses. See Publication 503 for more information on the credit for child and dependent care expenses.*

Qualifying Child

A qualifying child for purposes of the child tax credit must be all of the following.

- 1) Under age 17 at the end of 2003.
- 2) A citizen or resident alien of the United States.
- 3) Claimed as your dependent.
- 4) Your:
 - a) Son, daughter, stepson, stepdaughter, or adopted child (or a descendant of your son, daughter, stepson, stepdaughter, or adopted child—for example, your grandchild),
 - b) Brother, sister, stepbrother, or stepsister (or the child or grandchild of your brother, sister, stepbrother, or stepsister) if you care for the individual as you would your own child, or
 - c) Eligible foster child.

Adopted child. A child placed with you by an authorized placement agency for legal adoption is an adopted child even if the adoption is not final.

Eligible foster child. An eligible foster child is any child you cared for as your own and who is placed with you by an authorized placement agency.

Note. A child who was born or died in 2003 is considered to have lived with you for all of 2003 if your home was the child's home for the entire time he or she was alive during 2003.

Amount of Credit

The maximum credit that you can claim is \$1,000 for each qualifying child.

Limits on the credit. You must reduce your child tax credit if either (1) or (2), below, applies.

- 1) The amount on line 43 (Form 1040) or line 28 (Form 1040A) is less than the credit. If the amount is zero, you cannot take this credit because there is no tax to reduce. However, you may be able to take the **additional child tax credit**. See *Additional Child Tax Credit*, later.
- 2) Your **modified** adjusted gross income (AGI) is more than the amount shown below for your filing status.
 - Married filing jointly — \$110,000
 - Single, head of household, or qualifying widow(er) — \$75,000
 - Married filing separately — \$55,000

Modified AGI. For purposes of the child tax credit, your modified AGI is your AGI plus the following amounts that may apply to you.

- Any amount excluded from income because of the exclusion of income from Puerto Rico.
- Any amount on lines 43 and 48 of Form 2555, *Foreign Earned Income*.
- Any amount on line 18 of Form 2555-EZ, *Foreign Earned Income Exclusion*.
- Any amount on line 15 of Form 4563, *Exclusion of Income for Bona Fide Residents of American Samoa*.

If you do not have any of the above, modified AGI is the AGI amount on line 35 (Form 1040) or line 21 (Form 1040A).

Claiming the Credit

To claim the child tax credit, you must file Form 1040 or Form 1040A. You must provide the name and identification number (usually a social security number) on your tax return for each qualifying child.

Answer the *Questions* in your form instructions for line 49 (Form 1040) or line 33 (Form 1040A) to find out which child tax credit worksheet you can use to compute the credit.



If you answer **Yes** to question 1, 2, or 3 in your Form 1040 instructions or question 1 or 2 in your Form 1040A instructions, you must complete the Child Tax Credit Worksheet in Publication 972, Child Tax Credit.

For more information on the child tax credit, see the instructions for Form 1040 or Form 1040A.

Additional Child Tax Credit

This credit is for certain individuals who get less than the full amount of the child tax credit. The additional child tax credit may give you a refund even if you do not owe any tax.

How to claim the additional child tax credit. To claim the additional child tax credit, follow the steps below.

- 1) Make sure you figured the amount, if any, of your child tax credit. See *Claiming the Credit*, earlier.
- 2) Use Form 8812, *Additional Child Tax Credit*, to see if you can take the additional child tax credit only if you answered **Yes** on line 4 or line 5 of the *Child Tax Credit Worksheet*.
- 3) If you have an additional child tax credit on line 13 of Form 8812, carry it to line 65 (Form 1040) or line 42 (Form 1040A).

Decedents

If a member of the Armed Forces dies, a surviving spouse or **personal representative** handles duties such as filing any tax returns and claims for refund of withheld or estimated tax. A personal representative can be an executor, administrator, or anyone who is in charge of the decedent's assets.

This section discusses the special tax provisions that apply to individuals who:

- Die while serving in a combat zone or from wounds, disease, or injury incurred while serving in a combat zone, or
- Die from wounds or injury incurred in a terrorist or military action while a U.S. employee.



For information on the tax relief provisions that apply to individuals who died as a result of the terrorist attacks on April 19, 1995 (Oklahoma City), or September 11, 2001, or the terrorist attacks involving anthrax, see Publication 3920. For other information concerning decedents, get Publication 559.

Combat Zone Tax Forgiveness

If a member of the U.S. Armed Forces dies while in active service in a combat zone or from wounds, disease, or other injury received in a combat zone, the decedent's income tax liability is forgiven for the tax year in which death occurred and for any earlier tax year ending on or after the first day the member served in a combat zone in active service. (Forgiven tax is tax that does not have to be paid.) Any forgiven tax liability that has already been paid will be refunded, and any unpaid tax liability at the date of death will be forgiven.

In addition, any unpaid taxes for prior years will be forgiven and any prior year taxes paid after the date of death will be refunded.

This provision also applies to a member of the Armed Forces serving outside the combat zone if the service:

- Was in direct support of military operations in the zone, and
- Qualified the member for special military pay for duty subject to hostile fire or imminent danger.

For a description of combat zone, see *Combat Zone*, earlier.

Missing status. The date of death for a member of the Armed Forces who was in a missing status (missing in action or prisoner of war) is the date his or her name is removed from missing status for military pay purposes. This is true even if death actually occurred earlier.

Terrorist or Military Action Tax Forgiveness

Tax liability is forgiven for an individual who:

- 1) Is a military or civilian U.S. employee at death, and
- 2) Dies from wounds or injury incurred while a U.S. employee in a terrorist or military action.



Beginning in 2001, tax liability is forgiven for an individual who dies from wounds or injury incurred while a U.S. employee in a terrorist or military action regardless of where the terrorist or military action occurred.

The forgiveness applies to the tax year death occurred and for any earlier tax year beginning with the year before the year in which the wounds or injury occurred. A **terrorist or military action** is any terrorist activity primarily directed against the United States or its allies or any military action involving the U.S. Armed Forces resulting from violence or aggression against the United States or its allies.

Any multinational force in which the United States participates is considered an ally of the United States.

Example. Army Private John Kane died in 2003 of wounds incurred in a terrorist attack in 2002. His income tax liability is forgiven for all tax years from 2001 through 2003. Refunds are allowed for the tax years for which the period for filing a claim for refund has not ended.

Claims for Tax Forgiveness

If the tax-forgiveness provisions apply to a prior year's tax that has been paid and the period for filing a refund claim has not ended, the tax will be refunded. If any tax is still due, it will be canceled. Generally, the period for filing a claim for credit or refund of income tax is 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever is later.

If death occurred in a combat zone or from wounds, disease, or injury incurred in a combat zone, the deadline for filing a claim for credit or refund is extended using the rules discussed later under *Extension of Deadline*.

Procedures for claiming forgiveness. If the individual died in a combat zone or as a result of a terrorist or military action, use the following procedures for filing a claim for income tax forgiveness.

- File Form 1040 if a tax return has not been filed for the tax year. Form W-2 must accompany the return.
- File Form 1040X if a tax return has been filed. A separate Form 1040X must be filed for each year in question.

All returns and claims must be identified by writing "Enduring Freedom—KIA," "Kosovo Operation—KIA," "Desert Storm—KIA," or "Former Yugoslavia—KIA" in bold letters on the top of page 1 of the return or claim. On Forms 1040 and 1040X, the phrase "Enduring Freedom—KIA," "Kosovo Operation—KIA," "Desert Storm—KIA," or "Former Yugoslavia—KIA" must be written on the line for total tax. If the individual was killed in a terrorist action, write "KITA" on the front of the return and on the line for total tax. For example, write "KITA—Oklahoma City," "KITA—9/11," or "KITA—Anthrax," on the front of the return and on the line for total tax when referring to one of these attacks.

An attachment that includes a computation of the decedent's tax liability before any amount is forgiven and the amount that is to be forgiven should accompany any return or claim. For joint returns, see *Joint returns*, later.

Necessary documents. The following documents must accompany all returns and claims for refund (other than returns and claims relating to individuals who died as a result of the Oklahoma City, September 11, 2001, or anthrax terrorist attacks, that are discussed in Publication 3920).

- Form 1310, *Statement of Person Claiming Refund Due a Deceased Taxpayer*, and
- A certification from the Department of Defense or the Department of State.

For military and civilian employees of the Department of Defense, certification must be made by the Department on Form DoD 1300, *REPORT OF CASUALTY*. For civilian employees of all other agencies, certification must be a letter signed by the Director General of the Foreign Service, Department of State, or his or her delegate. The certification must include the deceased individual's name and social security number, the date of injury, the date of death, and a statement that the individual died in a combat zone or from a terrorist or military action. If the individual died as a result of a terrorist or military action, the statement also must include the fact that the individual was a U.S. employee at the date of injury and at the date of death.

If the certification has been received but there is not enough tax information to file a timely claim for refund, file Form 1040X with Form 1310. Include a statement saying that an amended claim will be filed as soon as the necessary tax information is available.

Where to file. These returns and claims must be filed at one of the following addresses.

U.S. Postal Service. If you use the U.S. Postal Service, file these returns and claims at the following address.

Internal Revenue Service
P.O. Box 4053
Woburn, MA 01888

Designated private delivery service. Private delivery services cannot deliver items to P.O. boxes. If you use a private delivery service, file these returns and claims at the following address.

Internal Revenue Service
Stop 661
Andover, MA 05501

You can use the following private delivery services to file these returns and claims.

- Airborne Express (Airborne): Overnight Air Express Service, Next Afternoon Service, and Second Day Service.
- DHL Worldwide Express (DHL): DHL “Same Day” Service and DHL USA Overnight.
- Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day, FedEx International Priority, and FedEx International First.
- United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.

The private delivery service can tell you how to get written proof of the mailing date.

Joint returns. Only the decedent’s part of the joint income tax liability is eligible for the refund or tax forgiveness. To determine the decedent’s part, the person filing the claim must:

- 1) Figure the income tax for which the decedent would have been liable as if a separate return had been filed,
- 2) Figure the income tax for which the spouse would have been liable as if a separate return had been filed, and
- 3) Multiply the joint tax liability by a fraction. The top number of the fraction is the amount in (1), above. The bottom number of the fraction is the total of (1) and (2).

The amount in (3) is the decedent’s tax liability that is eligible for the refund or tax forgiveness. If you are unable to complete this process, you should attach a statement of all income and deductions, indicating the part that belongs to each spouse. The IRS will make the proper allocation.

Residents of community property states. If the member of the Armed Forces was domiciled in a community property state and the spouse reported half the military pay on a separate return, the spouse can get a refund of taxes paid on his or her share of the pay for the years involved. The forgiveness of unpaid tax on the military pay also would apply to the half owed by the spouse for the years involved.

Filing Returns

This section discusses the special procedures for military personnel when filing federal tax returns. For information

on filing returns for those involved in a combat zone, see *Extension of Deadline*, later.

Where To File

Send your federal tax return to the Internal Revenue Service center for the place where you live. For example, Sgt. Kane, who is stationed in Maine but whose permanent home address is in California, should send her federal return to the service center for Maine. The instructions for Forms 1040, 1040A, and 1040EZ give the addresses for the service centers. If you are overseas and have an APO or FPO address, file your return with the Internal Revenue Service Center, Philadelphia, PA 19255–0215.

When To File

Most individual tax returns cover a calendar year, January through December. The regular due date for these tax returns is April 15 of the following year. If April 15 falls on a Saturday, Sunday, or legal holiday, your tax return is considered timely filed if it is filed by the next business day that is not a Saturday, Sunday, or legal holiday. For 2003 tax returns, the due date is April 15, 2004.

Extensions

You can receive an extension of time to file your return. Different rules apply depending on whether you live inside or outside the United States.

Inside the United States. You can receive an automatic 4-month extension to file your return if you file Form 4868 by the regular due date of your return. You can file it electronically or on paper. See Form 4868 for details.

The extension of time to file is automatic, and you will not receive any notice of approval. However, your request for an extension will be denied if it is not made timely. The IRS will inform you of the denial.



You cannot use the automatic extension if you choose to have IRS figure the tax or you are under a court order to file your return by the regular due date.

When you file your return. Enter the amount you paid on line 66, Form 1040. On Form 1040A, include the amount in the total on line 43. On Form 1040EZ, include the amount in the total on line 9. To the left of line 43 or line 9, enter “Form 4868” and show the amount paid.

Outside the United States and Puerto Rico. If you are a U.S. citizen or resident alien, you can qualify for an automatic extension of time until June 15 without filing Form 4868 if either of the following situations applies to you.

- 1) You live outside the United States and Puerto Rico and your main place of business or post of duty is outside the United States and Puerto Rico, or
- 2) You are in military or naval service on an assigned tour of duty outside the United States and Puerto Rico for a period that includes the entire due date of the return.

You will be charged interest on any amount not paid by the regular due date until the date the tax is paid.

If you use this automatic extension, you must attach a statement to the return showing that you met the requirement.

You can request an additional 2-month extension to file by August 16, 2004 by filing a paper Form 4868 by June 15, 2004, for a 2003 calendar year tax return. Write "Taxpayer Abroad" across the top of Form 4868.

Joint returns. For married persons filing a joint return, only one spouse needs to meet the requirements to take advantage of the automatic extension to June 15.

Separate returns. For married persons filing separate returns, only the spouse who meets the requirements qualifies for the automatic extension to June 15.

Payment of tax. An extension of time to file does not mean you have an extension of time to pay any tax due. You must estimate your tax due. You do not have to send in any payment of tax due when you file Form 4868. However, if you pay the tax after the regular due date, you will be charged interest from the regular due date to the date the tax is paid. You also may be charged a penalty for paying the tax late unless you have reasonable cause for not paying your tax when due.

If you file Form 4868 electronically, you can make your tax payment by authorizing an electronic funds withdrawal (direct debit) from your checking or savings account or by using a credit card.

For more details on how to pay the tax due, see the Form 4868 instructions.

Exception. If you are a member of the Armed Forces, you may qualify to defer (delay) payment of income tax that becomes due before or during your military service. You must notify the Internal Revenue Service that your ability to pay the income tax has been materially affected by your military service.

Your income tax will be deferred for a period not to exceed 180 days after termination or release from military service. If you pay the income tax in full by the end of the deferral period, you will not be charged interest or penalty for that period.

This exception does not apply to the employee's share of social security and Medicare taxes you may owe.

For more information see *Not in a combat zone* under *Extension of Deadline*, later.

Additional extension beyond August 15. You can request an extension beyond the 4-month extension by filing Form 2688 or by writing a letter to the IRS. Except in undue hardship cases, this additional extension will be granted only if Form 4868 has already been filed. Form 2688 or your letter will not be considered if it is filed after the extended due date. If you file Form 2688 and are granted an extension and the IRS discovers that the information you gave was false or misleading, the extension is void. You may then be subject to a penalty for filing late.



If you are unable to pay the tax owed by the end of the extension period, you may want to file Form 9465 to arrange an installment payment agreement with the IRS that reflects your ability to pay the tax owed.

Signing Returns

Generally, you must sign your return. However, if you are overseas or incapacitated, you can grant a **power of attorney** to an agent to file and sign your return.

If you are acting on behalf of someone serving in a combat zone, see *Filing Returns for Combat Zone or Contingency Operation Participants*, later.

A power of attorney also can be granted by filing Form 2848. These forms are available at your nearest legal assistance office. While other power of attorney forms may be used, they must contain the information required by Form 2848.

In Part I of the form, you must indicate that you are granting the power to sign the return, the tax form number, and the tax year for which the form is being filed. Attach the power of attorney to the tax return.

Joint returns. Generally, joint returns must be signed by both spouses. However, when a spouse is overseas, in a combat zone or qualified hazardous duty area, in a missing status, incapacitated, or deceased, a power of attorney may be needed to file a joint return.

Spouse overseas. If one spouse is overseas on military duty, there are two options when filing a joint return.

- One spouse can prepare the return, sign it, and send it to the other spouse to sign early enough so that it can be filed by the due date, or
- The spouse who expects to be overseas on the due date of the return can file Form 2848 specifically designating that the spouse who remains in the United States can sign the return for the absent spouse.

Spouse in combat zone/qualified hazardous duty area. If your spouse is unable to sign the return because he or she is serving in a combat zone/qualified hazardous duty area or is performing qualifying service outside of a combat zone/qualified hazardous duty area, and you do not have a power of attorney or other statement, you can sign for your spouse. Attach a signed statement to your return that explains that your spouse is serving in a combat zone.

Spouse in missing status. The spouse of a member of the Armed Forces who is in a missing status in a combat zone can still file a joint return. A joint return can be filed for any year beginning not more than 2 years after the end of the combat zone activities. A joint return filed under these conditions is valid even if it is later determined that the missing spouse died before the year covered by the return.

Spouse incapacitated. If your spouse cannot sign because of disease or injury and he or she tells you to sign, you can sign your spouse's name in the proper space on the return, followed by the words "by [your name], Husband (or Wife)." Be sure to sign your name in the space provided for your signature. Attach a dated statement, signed by you, to your return. The statement should include the form number of the return you are filing, the tax year, the reason your spouse could not sign, and that your spouse has agreed to your signing for him or her.

Spouse died during the year. If one spouse died during the year and the surviving spouse did not remarry

before the end of the year, the surviving spouse can file a joint return for that year writing in the signature area "Filing as surviving spouse." If an executor or administrator has been appointed, both he or she and the surviving spouse must sign the return filed for the decedent.

Refunds

In general, military personnel follow the same rules as other taxpayers concerning tax refunds. See your tax form instructions for information on what to do if you do not receive an expected refund and how to call to check on your refund status.



Use Form 8822 to notify the IRS if you move or change your address after filing your return. See How To Get Tax Help, near the end of this publication, for information about getting this form.

Extension of Deadline

Certain periods of time are disregarded when determining whether certain tax matters have been taken care of on time. For ease of understanding, this publication refers to these provisions as "extensions of deadlines." These deadline extensions should not be confused with other parts of the tax law that refer to extensions of time for performing acts.

Service That Qualifies for an Extension of Deadline

The deadline for filing tax returns, paying taxes, filing claims for refund, and taking other actions with the IRS is automatically extended if any of the following statements is true.

- You serve in the Armed Forces in a combat zone or you have qualifying service outside of a combat zone. (See *Qualifying service outside combat zone*, earlier.)
- You serve in the Armed Forces in a qualified hazardous duty area or are deployed overseas away from your permanent duty station in support of operations in a qualified hazardous duty area, but your deployment station is outside the qualified hazardous duty area. (In the rest of this discussion, the term "combat zone" includes a qualified hazardous duty area.)
- You serve in the Armed Forces on deployment outside the United States away from your permanent duty station while participating in a contingency operation. A contingency operation is a military operation that is designated by the Secretary of Defense or results in calling members of the uniformed services to active duty (or retains them on active duty) during a war or a national emergency declared by the President or Congress.

The deadline for IRS to take certain actions, such as collection and examination actions, is also extended. See *Combat Zone*, earlier, for the beginning dates for the Afghanistan area combat zone, the Kosovo area combat

zone, the Persian Gulf area combat zone, and the qualified hazardous duty areas.

Deadline extension period. Your deadline for taking actions with the IRS is extended for 180 days after the later of:

- The last day you are in a combat zone, have qualifying service outside of the combat zone, or serve in a contingency operation (or the last day the area qualifies as a combat zone or the operation qualifies as a contingency operation), or
- The last day of any continuous qualified hospitalization (defined later) for injury from service in the combat zone or contingency operation or while performing qualifying service outside of the combat zone.

In addition to the 180 days, your deadline is extended also by the number of days that were left for you to take the action with the IRS when you entered a combat zone (or began performing qualifying service outside the combat zone) or began serving in a contingency operation. If you entered the combat zone or began serving in the contingency operation before the period of time to take the action began, your deadline is extended by the entire period of time you have to take the action. For example, you had 3½ months (January 1 – April 15, 2003) to file your 2002 tax return. Any days of this 3½ month period that were left when you entered the combat zone (or the entire 3½ months if you entered the combat zone by January 1, 2003) are added to the 180 days when determining the last day allowed for filing your 2002 tax return.

Example 1. Captain Margaret Jones entered Saudi Arabia on December 1, 2001. She remained there through March 31, 2003, when she departed for the United States. She was not injured and did not return to the combat zone. The deadlines for filing Captain Jones' 2001, 2002, and 2003 returns are figured as follows.

The 2001 tax return. The deadline is January 10, 2004. This deadline is 285 days (180 plus 105) after Captain Jones' last day in the combat zone (March 31, 2003). The 105 additional days are the number of days in the 3½ month filing period that were left when she entered the combat zone (January 1 – April 15, 2002).

The 2002 tax return. The deadline is January 10, 2004. The deadline is 285 days (180 plus 105) after Capt. Jones' last day in the combat zone (March 31, 2003).

The 2003 tax return. The deadline is not extended because the 180-day extension period after March 31, 2003, ends on September 27, 2003, which is before the start of the filing period for her 2003 return (January 1 – April 15, 2004).

Example 2. Petty Officer Leonard Brown's ship entered the Persian Gulf on January 5, 2002. On February 15, 2002, Leonard was injured and was flown to a U.S. hospital. He remained in the hospital through April 21, 2003. The deadlines for filing Petty Officer Brown's 2001, 2002, and 2003 returns are figured as follows.

The 2001 tax return. The deadline is January 27, 2004. Petty Officer Brown has 281 days (180 plus 101) after his last day in the hospital (April 21, 2003) to file his 2001 return. The 101 additional days are the number of days in the 3½ month filing period that were left when he entered the combat zone (January 5 – April 15, 2002).

The 2002 tax return. The deadline is January 31, 2004. Petty Officer Brown has 285 days (180 plus 105) after April 21, 2003, to file his 2002 tax return. The 105 additional days are the number of days in the 2003 filing period that were left when he entered the combat zone.

The 2003 tax return. The deadline is not extended because the 180-day extension period after April 21, 2003, ends on October 18, 2003, which is before the start of the filing period for his 2003 return (January 1 – April 15, 2004).

Example 3. You generally have 3 years from April 15, 2000, to file a claim for refund against your timely filed 1999 tax return. This means that your claim normally must be filed by April 15, 2003. However, if you served in a combat zone from November 1, 2002, through March 23, 2003, and were not injured, your deadline for filing that claim is extended 346 days (180 plus 166) after you leave the combat zone. This extends your deadline to March 4, 2004. The 166 additional days are the number of days in the 3-year period for filing the refund claim that were left when you entered the combat zone on November 1 (November 1, 2002 – April 15, 2003).

Missing status. Time in a missing status (missing in action or prisoner of war) counts as time in a combat zone or a contingency operation.

Support personnel. The deadline extension provision also applies if you are serving in a combat zone or a contingency operation in support of the Armed Forces. This includes Red Cross personnel, accredited correspondents, and civilian personnel acting under the direction of the Armed Forces in support of those forces.

Qualified hospitalization. The hospitalization must be the result of an injury received while serving in a combat zone or a contingency operation. Qualified hospitalization means:

- Any hospitalization outside the United States, and
- Up to 5 years of hospitalization in the United States.

Actions extended. The actions to which the deadline extension provision applies include:

- Filing any return of income, estate, or gift tax (except employment and withholding taxes),
- Paying any income, estate, or gift tax (except employment and withholding taxes),
- Filing a petition with the Tax Court for redetermination of a deficiency, or for review of a Tax Court decision,
- Filing a claim for credit or refund of any tax,
- Bringing suit for any claim for credit or refund,

- Purchasing a replacement home to postpone paying tax on the gain on the sale (before May 7, 1997) of your old home,
- Making a qualified retirement contribution to an IRA,
- Allowing a credit or refund of any tax by the IRS,
- Assessment of any tax by the IRS,
- Giving or making any notice or demand by the IRS for the payment of any tax, or for any liability for any tax,
- Collection by the IRS of any tax due, and
- Bringing suit by the United States for any tax due.

If the IRS takes any actions covered by these provisions or sends you a notice of examination before learning that you are entitled to an extension of the deadline, contact your legal assistance office. No penalties or interest will be imposed for failure to file a return or pay taxes during the extension period.



Even though the deadline is extended, you may want to file a return earlier to receive any refund due. See Filing Returns, earlier.

Spouses. Spouses of individuals who served in a combat zone or contingency operation are entitled to the same deadline extension with two exceptions.

- The extension does not apply to a spouse for any tax year beginning more than 2 years after the date the area ceases to be a combat zone or the operation ceases to be a contingency operation.
- The extension does not apply to a spouse for any period the qualifying individual is hospitalized in the United States for injuries incurred in a combat zone or contingency operation.

Not in a combat zone. If you are a member of the Armed Forces, you may qualify to defer (delay) payment of income tax that becomes due before or during your military service. To qualify, you must:

- Be performing **military service**, and
- Notify the Internal Revenue Service that your ability to pay the income tax has been materially affected by your military service.

You will then be allowed up to 180 days after termination or release from military service to pay the tax. If you pay the tax in full by the end of the deferral period, you will not be charged interest or penalty for that period.

This exception does not apply to the employee's share of social security and Medicare taxes you may owe.

Military service. The term military service means the period beginning on the date on which you enter military service and ending on the date on which you are released from military service or die while in military service. In the case of a member of the National Guard, this includes service under a call to active service authorized by the President or the Secretary of Defense for a period of more than 30 consecutive days under section 502(f) of title 32, United States Code, for purposes of responding to a na-

tional emergency declared by the President and supported by Federal funds.

Request for deferment. If you have a current payment agreement, you must make a written request for deferment to the IRS office where you have the agreement.

If you have received a notice requesting payment, you must make a written request for deferment to the IRS office that issued the notice.

If you do not have a current payment agreement, you must wait until you receive a notice asking for payment before you request a deferral.

Your request must include your name, social security number, monthly income and source of income before military service, current monthly income, military rank, date you entered military service, and date you are eligible for discharge. If possible, enclosing a copy of your orders would be helpful.

The IRS will review your request and advise you in writing of its decision. Should you need further assistance, you can call the IRS at **1-800-829-1040** to discuss your situation.

Maximum rate of interest. Section 207 of the **Service members Civil Relief Act** limits the maximum interest rate you can be charged to 6% per year for obligations or liabilities incurred before your entry into military service. The reduced rate applies only if your service materially affects your ability to pay. This rate applies only to that interest charged during the period of your military service.

To substantiate your claim for this reduced interest rate, you must furnish the IRS a copy of your orders or reporting instructions that detail the call to military service. You must do so no later than 180 days after the date of your termination or release from military service.

Filing Returns for Combat Zone or Contingency Operation Participants

You can choose to file your return before the end of your extension period. File your return in accordance with instructions provided by the Armed Forces.

If you are acting on behalf of someone serving in a combat zone or contingency operation and you do not have a power of attorney from that person specifying that you can handle federal tax matters, the IRS will accept a general power of attorney or other statement signed by that person that authorizes you to act on his or her behalf. A copy must be attached to the tax return.

If it is not possible for the spouse of someone serving in a combat zone or contingency operation to obtain that person's signature on a joint return, power of attorney form, or other signed authorization to act on his or her behalf, the IRS will accept a written statement explaining that the husband or wife is serving in a combat zone or contingency operation. The statement must be signed by the spouse filing the tax return and attached to the return.

Outside the Combat Zone or Contingency Operation

If you do not qualify for the deadline extension provision, your 2003 return is due by the regular due date, April 15, 2004 (June 15, 2004, if you are stationed outside the

United States and Puerto Rico on April 15). Interest on any unpaid tax will be charged from April 15.

There are other provisions that extend the time for filing your return. See *Extensions*, earlier.

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate independently represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate toll free at **1-877-777-4778**.
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1-800-829-4059** if you are a TTY/TDD user.
- Visit the web site at **www.irs.gov/advocate**.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS*.

Free tax services. To find out what services are available, get Publication 910, *Guide to Free Tax Services*. It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.



Internet. You can access the IRS web site 24 hours a day, 7 days a week at **www.irs.gov** to:

- **E-file.** Access commercial tax preparation and e-file services available for free to eligible taxpayers.
- Check the amount of advance child tax credit payments you received in 2003.
- Check the status of your 2003 refund. Click on "Where's My Refund" and then on "Go Get My Refund Status." Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically) and have your 2003 tax return available because you will need to know your filing status and the exact whole dollar amount of your refund.
- Download forms, instructions, and publications.
- Order IRS products on-line.

- See answers to frequently asked tax questions.
- Search publications on-line by topic or keyword.
- Figure your withholding allowances using our Form W-4 calculator.
- Send us comments or request help by e-mail.
- Sign up to receive local and national tax news by e-mail.
- Get information on starting and operating a small business.

You can also reach us using File Transfer Protocol at **ftp.irs.gov**.



Fax. You can get over 100 of the most requested forms and instructions 24 hours a day, 7 days a week, by fax. Just call **703-368-9694** from your fax machine. Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

For help with transmission problems, call **703-487-4608**.

Long-distance charges may apply.



Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call **1-800-829-3676** to order current-year forms, instructions, and publications and prior-year forms and instructions. You should receive your order within 10 days.
- *Asking tax questions.* Call the IRS with your tax questions at **1-800-829-1040**.
- *Solving problems.* You can get face-to-face help solving tax problems every business day in IRS Taxpayer Assistance Centers. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to **www.irs.gov** or look in the phone book under "United States Government, Internal Revenue Service."
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call **1-800-829-4059** to ask tax or account questions or to order forms and publications.
- *TeleTax topics.* Call **1-800-829-4477** to listen to pre-recorded messages covering various tax topics.
- *Refund information.* If you would like to check the status of your 2003 refund, call **1-800-829-4477** for automated refund information and follow the recorded instructions or call **1-800-829-1954**. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically) and have your 2003 tax return available because you will need to know your filing status and the exact whole dollar amount of your refund.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to sometimes listen in on or record telephone calls. Another is to ask some callers to complete a short survey at the end of the call.



Walk-in. Many products and services are available on a walk-in basis.

- *Products.* You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
- *Services.* You can walk in to your local Taxpayer Assistance Center every business day to ask tax questions or get help with a tax problem. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. You can set up an appointment by calling your local Center and, at the prompt, leaving a message requesting Everyday Tax Solutions help. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience. To find the number, go to **www.irs.gov** or look in the phone book under "United States Government, Internal Revenue Service."



Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 workdays after your request is received. Use the address that applies to your part of the country.

- **Western part of U.S.:**
Western Area Distribution Center
Rancho Cordova, CA 95743-0001
- **Central part of U.S.:**
Central Area Distribution Center
P.O. Box 8903
Bloomington, IL 61702-8903
- **Eastern part of U.S. and foreign addresses:**
Eastern Area Distribution Center
P.O. Box 85074
Richmond, VA 23261-5074



CD-ROM for tax products. You can order IRS Publication 1796, *Federal Tax Products on CD-ROM*, and obtain:

- Current-year forms, instructions, and publications.

- Prior-year forms and instructions.
- Frequently requested tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
- Internal Revenue Bulletins.

Buy the CD-ROM from National Technical Information Service (NTIS) on the Internet at www.irs.gov/cdorders for \$22 (no handling fee) or call **1-877-233-6767** toll free to buy the CD-ROM for \$22 (plus a \$5 handling fee). The first release is available in early January and the final release is available in late February.



CD-ROM for small businesses. IRS Publication 3207, *Small Business Resource Guide*, is a must for every small business owner or any taxpayer about to start a business. This handy, interactive CD contains all the business tax forms, instructions and publications needed to successfully manage a business. In addition, the CD provides an abundance of other helpful information, such as how to prepare a business plan, finding financing for your business, and much more. The design of the CD makes finding information easy and quick and incorporates file formats and browsers that can be run on virtually any desktop or laptop computer.

It is available in early April. You can get a free copy by calling **1-800-829-3676** or by visiting the web site at www.irs.gov/smallbiz.

Index



To help us develop a more useful index, please let us know if you have ideas for index entries. See "Comments and Suggestions" in the "Introduction" for the ways you can reach us.

A	Expenses:	Gross 3
Advance earned income credit 23	Employee business 18	Individual retirement arrangements 6
Afghanistan 7	Moving 6	Interest rate (maximum) 30
Aliens 8	Extension of deadlines 28	Iraq 7
Amount of exclusion 8	Extension of time to file 26	Itemized deductions 18
Assistance (See Tax help)		
C	F	J
Child tax credit 23	Filing returns 26, 30	Joint returns 26, 27
Claim for refund:	Foreign income 5	
Sale of home 12	Foreign moves 6	K
Claims for tax forgiveness 25	Forms:	Kosovo 7
Combat zone:	1040 7, 18, 26	
Exclusion 7	1040A 26	M
Extension of deadlines 28	1040EZ 26	Military action tax forgiveness 25
Qualified hazardous duty area 7	1040NR 9	Miscellaneous itemized deductions 18
Tax forgiveness 24	1040X 12	Missing status 25, 27, 29
Comments on publication 3	2106 18, 19	More information (See Tax help)
Community property 5, 26	2106-EZ 18	Moving expenses 6
Contingency operation 28	2119 17	
Credits:	2688 27	N
Advance earned income 23	2848 27	Nonresident aliens 9
Child tax 23	3903 6	
Earned income 20	4868 26	P
	8822 28	Permanent change of station 6
	W-2 8	Persian Gulf 7
	Free tax services 30	Personal representative 24
		Power of attorney 27
D	G	Professional dues 20
Decedents 24	Gross income 3	Publications (See Tax help)
Deductions, itemized 18		
Dependents 10	H	Q
Domicile 5	Help (See Tax help)	Qualified hazardous duty area extension 28
Dual-status aliens 9	Home:	Qualifying child 23
	Away from 19	
E	Definition of 19	
Earned income credit 20	Sale of 12	
Educational expenses 20	Hospitalization 8, 28, 29	
Employee business expenses 18		
Exemptions 9	I	
	Income:	
	Foreign source 5	

R			
Refund, filing a claim:			
Sale of home	12	What to report now	17
Refunds	28	Sale of home in 2003	12
Reimbursements:		Separate returns	27
Employee business		Servicemembers Civil Relief	
expenses	18	Act	30
Moving and storage	6	Serving in a combat zone	8
Uniforms	19	Spouse:	
Reservists:		Deadline extension	29
Travel	5	Died	27
Uniforms	20	Incapacitated	27
Resident aliens	9	Missing	27
Returns:		Nonresident alien	9
Filing	26	Overseas	27
Signing	27	Statute of limitations	17
		Suggestions for publication	3
S			
Sale of home before May 7, 1997:		T	
Postponing gain	13	Tax forgiven	24
		Tax help	30
		Taxpayer Advocate	30
		Temporary work location	19
		Terrorist tax forgiveness	25
		Transportation	19
		Transportation expenses	19
		Travel expenses	19
		TTY/TDD information	30
		U	
		Uniforms	19
		W	
		When to file	26
		Where to file	26
		Y	
		Yugoslavia	7

Tax Publications for Individual Taxpayers

See *How To Get Tax Help* for a variety of ways to get publications, including by computer, phone, and mail.

General Guides

- 1** Your Rights as a Taxpayer
- 17** Your Federal Income Tax (For Individuals)
- 334** Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)
- 509** Tax Calendars for 2004
- 553** Highlights of 2003 Tax Changes
- 910** Guide to Free Tax Services

Specialized Publications

- 3** Armed Forces' Tax Guide
- 54** Tax Guide for U.S. Citizens and Residents Aliens Abroad
- 225** Farmer's Tax Guide
- 378** Fuel Tax Credits and Refunds
- 463** Travel, Entertainment, Gift, and Car Expenses
- 501** Exemptions, Standard Deduction, and Filing Information
- 502** Medical and Dental Expenses (Including the Health Coverage Tax Credit)
- 503** Child and Dependent Care Expenses
- 504** Divorced or Separated Individuals
- 505** Tax Withholding and Estimated Tax
- 514** Foreign Tax Credit for Individuals
- 516** U.S. Government Civilian Employees Stationed Abroad
- 517** Social Security and Other Information for Members of the Clergy and Religious Workers
- 519** U.S. Tax Guide for Aliens
- 521** Moving Expenses
- 523** Selling Your Home
- 524** Credit for the Elderly or the Disabled
- 525** Taxable and Nontaxable Income
- 526** Charitable Contributions
- 527** Residential Rental Property
- 529** Miscellaneous Deductions
- 530** Tax Information for First-Time Homeowners

- 531** Reporting Tip Income
- 533** Self-Employment Tax
- 536** Net Operating Losses (NOLs) for Individuals, Estates, and Trusts
- 537** Installment Sales
- 541** Partnerships
- 544** Sales and Other Dispositions of Assets
- 547** Casualties, Disasters, and Thefts
- 550** Investment Income and Expenses
- 551** Basis of Assets
- 552** Recordkeeping for Individuals
- 554** Older Americans' Tax Guide
- 555** Community Property
- 556** Examination of Returns, Appeal Rights, and Claims for Refund
- 559** Survivors, Executors, and Administrators
- 561** Determining the Value of Donated Property
- 564** Mutual Fund Distributions
- 570** Tax Guide for Individuals With Income From U.S. Possessions
- 571** Tax-Sheltered Annuity Plans (403(b) Plans)
- 575** Pension and Annuity Income
- 584** Casualty, Disaster, and Theft Loss Workbook (Personal-Use Property)
- 587** Business Use of Your Home (Including Use by Daycare Providers)
- 590** Individual Retirement Arrangements (IRAs)
- 593** Tax Highlights for U.S. Citizens and Residents Going Abroad
- 594** What You Should Know About the IRS Collection Process
- 595** Tax Highlights for Commercial Fishermen
- 596** Earned Income Credit (EIC)
- 721** Tax Guide to U.S. Civil Service Retirement Benefits
- 901** U.S. Tax Treaties

- 907** Tax Highlights for Persons with Disabilities
- 908** Bankruptcy Tax Guide
- 911** Direct Sellers
- 915** Social Security and Equivalent Railroad Retirement Benefits
- 919** How Do I Adjust My Tax Withholding?
- 925** Passive Activity and At-Risk Rules
- 926** Household Employer's Tax Guide
- 929** Tax Rules for Children and Dependents
- 936** Home Mortgage Interest Deduction
- 946** How To Depreciate Property
- 947** Practice Before the IRS and Power of Attorney
- 950** Introduction to Estate and Gift Taxes
- 967** The IRS Will Figure Your Tax
- 968** Tax Benefits for Adoption
- 969** Medical Savings Accounts (MSAs)
- 970** Tax Benefits for Education
- 971** Innocent Spouse Relief
- 972** Child Tax Credit
- 1542** Per Diem Rates
- 1544** Reporting Cash Payments of Over \$10,000 (Received in a Trade or Business)
- 1546** The Taxpayer Advocate Service of the IRS

Spanish Language Publications

- 1SP** Derechos del Contribuyente
- 579SP** Cómo Preparar la Declaración de Impuesto Federal
- 594SP** Comprendiendo el Proceso de Cobro
- 596SP** Crédito por Ingreso del Trabajo
- 850** English-Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service
- 1544SP** Informe de Pagos en Efectivo en Exceso de \$10,000 (Recibidos en una Ocupación o Negocio)

Commonly Used Tax Forms

See *How To Get Tax Help* for a variety of ways to get forms, including by computer, fax, phone, and mail. For fax orders only, use the catalog number when ordering.

Form Number and Title	Catalog Number	Form Number and Title	Catalog Number
1040 U.S. Individual Income Tax Return	11320	2106 Employee Business Expenses	11700
Sch A&B Itemized Deductions & Interest and Ordinary Dividends	11330	2106-EZ Unreimbursed Employee Business Expenses	20604
Sch C Profit or Loss From Business	11334	2210 Underpayment of Estimated Tax by Individuals, Estates, and Trusts	11744
Sch C-EZ Net Profit From Business	14374	2441 Child and Dependent Care Expenses	11862
Sch D Capital Gains and Losses	11338	2848 Power of Attorney and Declaration of Representative	11980
Sch D-1 Continuation Sheet for Schedule D	10424	3903 Moving Expenses	12490
Sch E Supplemental Income and Loss	11344	4562 Depreciation and Amortization	12906
Sch EIC Earned Income Credit	13339	4868 Application for Automatic Extension of Time To File U.S. Individual Income Tax Return	13141
Sch F Profit or Loss From Farming	11346	4952 Investment Interest Expense Deduction	13177
Sch H Household Employment Taxes	12187	5329 Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts	13329
Sch J Farm Income Averaging	25513	6251 Alternative Minimum Tax—Individuals	13600
Sch R Credit for the Elderly or the Disabled	11359	8283 Noncash Charitable Contributions	62299
Sch SE Self-Employment Tax	11358	8582 Passive Activity Loss Limitations	63704
1040A U.S. Individual Income Tax Return	11327	8606 Nondeductible IRAs	63966
Sch 1 Interest and Ordinary Dividends for Form 1040A Filers	12075	8812 Additional Child Tax Credit	10644
Sch 2 Child and Dependent Care Expenses for Form 1040A Filers	10749	8822 Change of Address	12081
Sch 3 Credit for the Elderly or the Disabled for Form 1040A Filers	12064	8829 Expenses for Business Use of Your Home	13232
1040EZ Income Tax Return for Single and Joint Filers With No Dependents	11329	8863 Education Credits	25379
1040-ES Estimated Tax for Individuals	11340	9465 Installment Agreement Request	14842
1040X Amended U.S. Individual Income Tax Return	11360		