

# FEDERAL TAX ISSUES

**T**his section gives general information about federal income and estate tax rules that may apply to deceased service members and their surviving spouses and family members. It is not intended to provide specific tax advice or to take the place of a consultation with a tax professional, such as a certified public accountant or a tax attorney. **This section only discusses U.S. federal tax rules and does not cover state or local tax rules, which may be different from the federal rules discussed in this section and may differ from state to state.**

Because this section is only a general summary, it omits many details about the federal income and estate tax rules it describes. Many of these details, along with answers to questions surviving family members may have, can be found in IRS Publication 3, *Armed Forces Tax Guide*, and IRS Publication 559, *Survivors, Executors and Administrators*. These publications, along with other IRS forms and publications, may be obtained from the IRS website at [www.irs.gov](http://www.irs.gov) or by calling (800) 829-3676. Additional information addressing how to find answers to your tax questions, including the websites of state tax authorities, can be found in the section on State Resources. **Surviving family members are also strongly encouraged to consult with a tax professional for advice about their particular circumstances and for answers to questions they may have.** Under most circumstances, a certified public accountant should suffice.

## Income Tax Returns

*Are income tax returns required to be filed on behalf of the deceased service member?*

Yes. A final income tax return must be filed on behalf of the deceased spouse or family member regardless of the timing or circumstances of death.

*May a surviving spouse file a joint income tax return with the deceased service member?*

Under most circumstances a surviving spouse is eligible to file a joint income tax return with the deceased service member for the year the death occurred, provided that the surviving spouse did not remarry before the end of the year. If a court has appointed an executor or administrator for the estate of the deceased service member, a joint

return for the year of death can only be filed by both the surviving spouse and the executor or administrator. The executor or administrator can also choose to file a separate return.

In addition, under most circumstances the surviving spouse may file a joint return for the next two years after the service member's death if the surviving spouse remains unmarried throughout the year and maintains a household which is the principal place of residence of a child (including a stepchild) for whom the surviving spouse is entitled to take a dependency deduction.

*What if the surviving family member does not file a joint income tax return with the deceased service member?*

If the surviving family member does not file a joint return, a final tax return should be filed by the court-appointed executor or administrator of the deceased service member's estate or, if no such person has been appointed by a court, by any person in possession of the deceased service member's property.

*When should the income tax return be filed?*

The income tax return for the year in which the service member died is generally due by April 15 of the following year. However, extensions are generally available upon a timely request. Also, an automatic extension may be available because of the military service of the deceased service member.

*How does a surviving family member receive an extension?*

There are a number of ways a surviving family member may be eligible for an extension to file a return. A two-month automatic extension is available for service members who were stationed or serving abroad at the time the return was due (generally April 15). Additional extensions are available for those service members who served in a combat zone or outside the United States in support of contingency operations. These extensions are also available for a spouse filing a joint income tax return with the deceased service member.

In addition to these extensions, which are specific to military personnel, all taxpayers are eligible to receive an automatic four-month extension to file an income tax return if a Form 4868, Application for Automatic Extension of Time to File U.S. Individual Tax Return, is filed by the regular due date of the return.

*If a taxpayer receives an extension for filing an income tax return, does he or she also receive an extension for the payment of any taxes owed?*

No. An extension of time to file a tax return does not mean the taxpayer receives an extension to pay the amount of any taxes that are due. Generally, if a taxpayer requests an extension, he or she should estimate and pay the amount of tax due by the regular due date. Interest



generally will be charged on any unpaid tax liability from the regular due date to the date the tax is finally paid. Also, penalties may be charged unless there is reasonable cause for late payment.

*Are there any special U.S. federal income tax issues that arise from the fact that the service member died while serving in the military?*

Yes. Congress has created two programs to reduce or eliminate the income taxes owed by service members who serve in combat zones: the Combat Zone Exclusion and Combat Zone Forgiveness. Each program is described below.

### **The Combat Zone Exclusion**

The Combat Zone Exclusion permits the exclusion of certain pay from income as the result of having served in a combat zone or other qualifying service. This means that the amounts that qualify for the exclusion do not have to be reported as income on any tax returns thereby making those amounts “tax-free”. Under many circumstances, the military will automatically adjust withholding to account for the Combat Zone Exclusion so that whoever prepares the income tax return will not need to make a separate adjustment to receive the tax-free treatment of qualifying income. However, surviving family members may wish to have a tax professional verify that this has been done correctly.

If the deceased service member served in a combat zone or performed other qualifying service during part of any month, all of the military pay received for that month is excluded from income, subject to certain limits for commissioned officers. A combat zone is any area the President designates as an area in which the United States is engaging in combat.

The deceased service member generally will be eligible for the Combat Zone Exclusion during periods in which any of the following apply:

- the service member was assigned on official temporary duty to a combat zone;
- the service member qualified for hostile fire or imminent danger pay while in a combat zone or while performing other qualifying service;
- the service member became a prisoner of war or was missing in action;
- the service member was outside of a combat zone but served in direct support of military operations in a combat zone; or
- the service member was hospitalized as a result of wounds, disease or injury incurred in a combat zone, except that the exclusion does not apply for any month more than two years after the termination of combat activities in the combat zone, as specified by the President.



## Combat Zone Forgiveness

Combat Zone Forgiveness allows certain income taxes to be forgiven, meaning the tax does not need to be paid. If the service member died while serving in a combat zone or from wounds, disease or other injury received in a combat zone, his or her tax liability will be forgiven for the tax year in which death occurred and for any earlier tax year ending on or after the first day the service member actively served in a combat zone. For example, if a service member entered a combat zone in December of 2004 and died in 2005 from wounds, disease or other injury incurred while in the combat zone, tax forgiveness applies to both 2004 and 2005 tax years. The tax forgiveness applies to both military and civilian income for the period in which the tax forgiveness applies (including amounts such as salary that are paid after the time of death). If taxes qualifying for forgiveness have already been paid, a refund claim should be filed, as discussed below. Any unpaid tax liability of the deceased service member at the date of death will be forgiven.

*Under what circumstances could the Combat Zone Exclusion apply and income tax forgiveness not apply?*

If a service member served in a combat zone and qualified for the Combat Zone Exclusion, but left the combat zone and died under circumstances not relating to service in the combat zone, income tax forgiveness will not apply.

*Are any tax forgiveness programs available if a service member is killed by terrorist activity or during military operations but was not serving in a combat zone?*

Tax liability is forgiven for any service member who dies from wounds or injuries incurred in certain terrorist or military actions, other than training exercises. Forgiveness applies if the terrorist activity was primarily directed against the United States or its allies or if the military action involved the armed forces of the United States and resulted 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. The forgiveness applies to the tax year in which the service member died as well as to all earlier tax years beginning with the year before the year in which the wounds or injury occurred.

## Refunds and Amended Returns

*What is the process for claiming tax forgiveness or a refund?*

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, a refund claim should be filed. If any tax is still due, it will be cancelled. 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. However, an automatic extension of the time for filing a claim for credit or refund may be available if the service member was serving in a combat zone or in support of contingency operations. Surviving family members should consult a tax professional to determine whether an extension of the period for filing a claim for refund is available.

If a service member died in a combat zone or as a result of a terrorist or military action, a claim for tax forgiveness can be made by:

- filing a Form 1040 if a tax return has not been filed for the tax year; or
- filing a Form 1040X if a tax return has been filed. A separate Form 1040X must be filed for each year in question.

If a court has appointed an executor or administrator for the estate of the deceased service member, the executor or administrator must participate in claiming the refund, either by filing a joint return with the spouse of the deceased service member or by filing a separate return. When filing a claim for tax forgiveness a number of documents will be required, including a Form DD 1300, Report of Casualty, for the deceased service member, and additional rules will apply.

*How can surviving family members determine the amount of income tax that is eligible for tax forgiveness?*

If the deceased service member was married to the surviving family member and the surviving family member files a joint return, only the service member's part of the joint income tax liability is eligible for the refund or tax forgiveness. If it is difficult to determine what portion of income is eligible for tax forgiveness, the surviving spouse may attach a statement of all income and deductions, and indicate the part that belongs to each spouse. The IRS will then make the proper allocation.

If the deceased service member and spouse lived in a community property state, the surviving spouse may receive tax forgiveness for any taxes due or paid on the surviving spouse's share of the deceased service member's income for the years involved.

If the deceased service member was a family member other than a spouse, the court-appointed executor or administrator of his or her estate is the person responsible for filing a refund claim for all U.S. federal income taxes paid on his or her income for the years involved. In addition, his or her estate will also be forgiven any unpaid U.S. federal income tax owed.

*What if the income tax return for the deceased service member has been filed and some of his or her income qualified for exclusion or forgiveness or some other mistake is discovered?*

If a mistake was made calculating the taxes owed, for example if all of the income earned during the year was not reported or a credit or



deduction was not claimed, an amended or corrected return should be filed using Form 1040X, Amended U.S. Individual Income Tax Return. If a court has appointed an executor or administrator for the estate of the deceased service member, the executor or administrator must participate in amending or correcting the return, either by filing jointly with the spouse of the deceased service member or by filing separately. The amended or corrected return should include copies of any schedules that have been changed and any necessary forms not included with the original return. The Form 1040X should be submitted after a refund has been received or by the due date of the return, whichever is earlier.

*Does the Servicemembers Civil Relief Act apply to the tax liabilities owed by the deceased service member?*

The Servicemembers Civil Relief Act (the “SCRA”) was designed primarily to protect the interests of service members on active duty by providing for the temporary suspension of judicial and administrative proceedings and other transactions that may adversely affect the civil rights of service members. Under certain circumstances, the SCRA may serve to stay court enforcement of tax assessments on personal or real property. Additionally, the SCRA may defer the deadlines for the payment of federal, state or local taxes without interest or penalties. Surviving family members should consult with a legal advisor concerning the possible application of the SCRA.

## Estate Taxes

*When should estate tax returns be filed?*

It may be necessary to file estate tax returns, depending on the size of the deceased service member’s estate. For the vast majority of estates, however, an estate tax return will not be required and no estate taxes will be owed. If estate tax returns are required, the returns should be filed by the court-appointed executor or administrator of the estate. Federal returns and any estate taxes for the estate of a deceased person generally are due nine months after the date of death. Extensions for filing are available, although taxes should be paid on time to avoid interest and penalties. If the deceased service member died while serving in a combat zone or died from wounds, disease or other injury received in a combat zone, special reduced estate tax rates will apply. Generally, no federal estate tax will be due with respect to any property received by a surviving spouse, whether outright or in certain types of trusts, from the deceased service member’s estate, regardless of the size of the estate. The surviving family member (or the court-appointed executor or administrator, if there is such a person) should consult a tax professional regarding the filing requirements, estate tax rates, available credits and deductions and applicable deadlines.



*How will a surviving family member be taxed if he or she receives all or a portion of the deceased service member's estate?*

Generally, the cash and other property of an estate received by a beneficiary will not be subject to income tax. However, certain property, such as retirement benefits and income earned on property of the estate in any year during the estate's administration, may be subject to income tax. Income tax that is not eligible for tax forgiveness is paid by the estate (which is a separate taxpayer for income tax purposes) if the money or property is not distributed to surviving family members during that year. To the extent money or property is distributed to surviving family members in that year, such tax must be paid by those who receive distributions in that year.

The estate may be required to file its own income tax returns, depending on the amount of income earned in the estate in the year in question. If that happens, information will be sent to any other beneficiaries who receive distributions to inform them of their respective personal income tax responsibility, if any, flowing from these distributions.

## **Taxation of Financial Benefits**

*Will any of the money received by surviving family members be taxed?*

Surviving family members may receive various payments in connection with the death of a service member. Surviving family members will not be required to pay tax upon the receipt of many of the payments. Such tax-free payments may include, but are not limited to, the death gratuity, life insurance proceeds, grants from the Intrepid Fallen Heroes Fund, and DIC payments, each of which is discussed in more detail below. For information about the rules that apply to other payments that surviving family members may receive, such as those from 401(k) accounts and Individual Retirement Accounts, surviving family members are urged to consult with a tax professional.

### **The Death Gratuity**

The military services pay a tax-free death gratuity of \$12,000 if the service member died after September 10, 2001 and the death occurred while on active duty or within 120 days after release, if the death was a result of a service-connected cause.

Under a recent retroactive change in the tax law, the rules governing the taxation of the death gratuity have changed. Previously, the death gratuity was \$6,000 but only \$3,000 was nontaxable. Under the new law, if a surviving family member receives a death gratuity because of a death that occurred after September 10, 2001 and the surviving family member paid taxes on any portion of that death gratuity, he or she may be able to claim a refund. Surviving family members should contact a tax professional concerning the availability of a refund as a result of this change in law.



Surviving family members can contact the IRS with tax questions by calling (800) 829-1040.

To contact the Taxpayer Advocate call toll-free (877) 777-4778 or visit the website [www.irs.gov/advocate](http://www.irs.gov/advocate).



In early 2005, Congressional legislation was proposed to increase significantly the amount paid as the Death Gratuity, possibly even with retroactive effect. Surviving family members are encouraged to contact their CAO to determine the status of this and any other pending legislation that might have an effect on the families of deceased service members.

### **Life Insurance Proceeds**

Generally, any life insurance proceeds received as a result of the death of a service member will not be subject to income tax. However, the life insurance policy itself may be includible in the estate of the deceased service member and therefore may be subject to estate tax.

### **Intrepid Fallen Heroes Fund**

Recipients do not have to pay tax on grants received from the Intrepid Fallen Heroes Fund.

### **Dependency and Indemnity Compensation**

The Department of Veterans Affairs pays Dependency and Indemnity Compensation (DIC) if the service member died while on active duty or as a result of injury incurred while on active duty. Please see the section on General Financial Assistance for more information on DIC payments. All DIC payments are exempt from tax.

*Where can surviving family members get additional information or help with unresolved tax issues?*

The IRS can provide answers to many questions. Surviving family members can get help with unresolved tax issues, order free publications and forms, ask about tax consequences and get more information from the IRS in several ways.

To find out what other services are available, the IRS makes available Publication 910, Guide to Free Tax Services, which lists free tax publications and services, and contains an index of tax topics. Surviving family members can obtain this publication, as well as other publications at [www.irs.gov](http://www.irs.gov). Publications can also be ordered by calling: (800) 829-3676. Orders are generally delivered within 10 days.

Surviving family members who are unable to resolve a problem through direct IRS assistance at the IRS's toll free number above should contact a Taxpayer Advocate. The Taxpayer Advocate independently represents taxpayer interests and concerns within the IRS.

**Since this section is only a general summary of potential federal tax issues, taxpayers are encouraged to use these additional resources and to consult with a tax professional.**