

Part III - Administrative, Procedural, and Miscellaneous

Tax Relief for Those Involved in Operation Iraqi Freedom

Notice 2003-21

PURPOSE

This notice provides guidance in a question and answer format on the tax relief provided under Executive Order No. 12744, 56 Fed. Reg. 2663 (Jan. 23, 1991), for U.S. military and support personnel involved in the military operations in the "Arabian Peninsula Areas," as defined below.

BACKGROUND

The Executive Order, effective January 17, 1991, designated the "Arabian Peninsula Areas," as defined below, as a combat zone for purposes of section 112 of the Internal Revenue Code. No authority has terminated the designation, which continues to be in effect.

The provisions of the Code affected by the designation of a combat zone include the following:

- (1) Section 2(a)(3) (relating to the special rule where a deceased spouse was in missing status);
- (2) Section 112 (relating to the exclusion from gross income of certain combat pay received by members of the U.S. Armed Forces);
- (3) Section 692 (relating to income taxes of members of the U.S. Armed Forces on death);
- (4) Section 2201 (relating to estate tax as to members of the U.S. Armed Forces dying in a combat zone or as a result of wounds, disease or injury suffered while serving in a combat zone);
- (5) Section 3401(a)(1) (defining wages relating to combat pay for members of the U.S. Armed Forces);
- (6) Section 4253(d) (relating to taxation of telephone service originating from members of the U.S. Armed Forces in a combat zone);
- (7) Section 6013(f)(1) (relating to a joint return where an individual is in missing status as a result of service in a combat zone); and
- (8) Section 7508 (relating to the time for performing certain acts (including filing a return; paying, assessing or collecting a tax; claiming a refund, litigating a suit; and performing any act listed in Rev. Proc. 2002-71, 2002-46 I.R.B. 850) postponed by reason of service in a combat zone).

Under the Executive Order, the deadline extension provisions under section 7508 apply to members of the U.S. Armed Forces (and those serving in support of the U.S. Armed Forces) in the combat zone.

QUESTIONS AND ANSWERS

The following questions and answers apply to members of the U.S. Armed Forces on active duty and, where applicable in Part 2, to those serving in support of the U.S. Armed Forces and are patterned after the questions and answers in Notice 2002-17, 2002-1 C.B. 567 (Tax Relief for Those Involved in Operation Enduring Freedom); Notice 99-30, 1999-1 C.B. 1135 (Tax Relief for Those Affected by Operation Allied Force); and Notice 96-34, 1996-1 C.B. 379 (Tax Relief for Those Affected by Operation Joint Endeavor). A taxpayer covered by the relief provisions discussed in this Notice (a “covered taxpayer”) should write “Combat Zone” in red at the top of his or her return. A covered taxpayer who receives a notice from the IRS regarding a collection or examination matter should return the notice to the IRS with the words “Combat Zone” at the top of the notice and on the envelope so the IRS can suspend the action. For additional information on the tax treatment of members of the U.S. Armed Forces, including reservists, decedents, or persons missing in action, consult Publication 3, Armed Forces’ Tax Guide.

PART 1 -- MILITARY PAY EXCLUSION

Q-1: What geographic areas are included in the combat zone covered by this Notice?

A-1: The geographic areas in the combat zone (the “Arabian Peninsula Areas”) include

- The Persian Gulf,
- The Red Sea,
- The Gulf of Oman,
- The portion of the Arabian Sea that lies 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.

The Arabian Peninsula Areas include the airspace above such locations.

Q-2: I am a member of the U.S. Armed Forces performing services in the Arabian Peninsula Areas. Is any part of my 2002 military pay for serving in this area excluded from gross income?

A-2: Yes. The Arabian Peninsula Areas constitute the combat zone. If you serve in the combat zone as an enlisted member or as a warrant officer (including commissioned warrant officers) for any part of a month, all your military pay received for military service that month is excluded from gross income. For commissioned officers, the monthly exclusion is capped at the highest enlisted pay, plus any hostile fire or

imminent danger pay received. Therefore, for 2002, the most a commissioned officer can earn tax-free each month is \$5,532.90 (\$5,382.90, the highest monthly enlisted pay, plus \$150.00 hostile fire or imminent danger pay). For 2003, the most a commissioned officer can earn tax-free each month is \$5,882.70. Amounts excluded from gross income are not subject to federal income tax.

Q-3: My husband and I are both enlisted members of the U.S. Armed Forces serving in the combat zone. Are we both entitled to the income tax exclusion for military pay?

A-3: Yes. Each of you qualifies for the income tax exclusion for your military pay.

Q-4: I am a member of the U.S. Armed Forces stationed on a ship in the Indian Ocean. I fly missions over the Arabian Peninsula Areas as part of the military operations in the combat zone. Is any part of my military pay excluded from gross income?

A-4: Yes. The combat zone includes the airspace over the Arabian Peninsula Areas, so you are serving in the combat zone. See Q & A-2 for a discussion of the amount of your military pay that is excluded.

Q-5: If I am injured and hospitalized while serving in the U.S. Armed Forces in the combat zone, is any of my military pay excluded from gross income?

A-5: Yes. Military pay received by enlisted members who are hospitalized as a result of injuries sustained while serving in the combat zone is excluded from gross income for the period of hospitalization, subject to the 2-year limitation provided below. Commissioned officers have a similar exclusion, limited to the maximum enlisted pay amount per month. See Q & A-2. These exclusions from gross income for hospitalized enlisted members and commissioned officers end 2 years after the date of termination of the designation as a combat zone.

Q-6: My wife is currently serving in the U.S. Armed Forces in the combat zone and will be eligible for discharge when she returns home. If she is discharged upon her return, will the payment for the annual leave that she accrued during her service in the combat zone be excluded from gross income?

A-6: Yes. Annual leave payments to enlisted members of the U.S. Armed Forces upon discharge from service are excluded from gross income to the extent the annual leave was accrued during any month in any part of which the member served in the combat zone. If your wife is a commissioned officer, the portion of the payment she receives for annual leave accrued during any month in any part of which she served in the combat zone is excluded. The annual leave payment is not excludable to the extent it exceeds the maximum enlisted pay amount (see Q & A-2) for the month of service to which it relates less the amount of military pay already excluded for that month.

Q-7: I am an enlisted member serving in the combat zone. If I reenlist early while I am in the combat zone and receive my reenlistment bonus several months later when I am

stationed outside the combat zone, is any part of my reenlistment bonus excluded from gross income?

A-7: Yes. The reenlistment bonus is excluded from gross income although received in a month that you were outside the combat zone, because you completed the necessary action for entitlement to the reenlistment bonus in a month during which you served in the combat zone.

Q-8: My brother, who is a civilian in the merchant marine, is on a ship that transports military supplies between the United States and the combat zone. Is he entitled to the combat zone military pay exclusion?

A-8: No. Those serving in the merchant marine are not members of the U.S. Armed Forces. The combat zone military pay exclusion applies only to members of the U.S. Armed Forces. The U.S. Armed Forces include all regular and reserve components of the uniformed services that are under the control of the Secretaries of Defense, Army, Navy, and Air Force, and the Secretary of Homeland Security with respect to the Coast Guard.

Q-9: My husband is a member of the U.S. Armed Forces performing services as part of Operation Iraqi Freedom, but he is not in the combat zone and he is not receiving hostile fire/imminent danger pay. Is he entitled to the military pay exclusion?

A-9: No. U.S. Armed Forces members serving outside the combat zone are not entitled to the military pay exclusion, unless they are serving in direct support of military operations in the combat zone for which they receive hostile fire/imminent danger pay. On April 11, 2003, the Department of Defense certified that effective January 1, 2003, military personnel serving in direct support of Operation Iraqi Freedom in Turkey and Israel, and effective April 11, 2003, military personnel deployed to water areas of the Eastern Mediterranean that lie east of 30 degrees east longitude in direct support of Operation Iraqi Freedom, are eligible for all combat zone tax benefits. For a more detailed discussion of the tax treatment of military personnel, see Publication 3, Armed Forces' Tax Guide.

Q-10: How do I certify my entitlement to the military pay exclusion?

A-10: Your service branch must certify your entitlement on the Form W-2 it provides you. If you believe you are entitled to the exclusion, but it is not reflected on your Form W-2, ask your service branch to issue a corrected Form W-2.

PART 2 -- EXTENSION OF DEADLINES

Q-11: I have been serving in the Arabian Peninsula Areas since December 1, 2002. I understand that the deadline for performing certain actions required by the internal revenue laws is extended as a result of my service. On what date did these deadline extensions begin?

A-11: The deadline extensions apply to most tax actions required to be performed on or after January 17, 1991, or the date you began serving in the combat zone, whichever is later. In your case, the date that the deadline extensions began is December 1, 2002.

Q-12: My son is a member of the U.S. Armed Forces, and he has been serving in the combat zone since February 1, 2003. Is he entitled to an extension of time for filing and paying his 2002 federal income taxes? Are any assessment or collection deadlines extended?

A-12: For both questions, the answer is yes. In general, the deadlines for performing certain actions applicable to his taxes are extended for the period of his service in the combat zone, plus 180 days after his last day in the combat zone. This extension applies to the filing and paying of your son's 2002 income taxes. Also, in addition to the 180-day period, your son's extension period includes the 74-day period that was left before the April 15, 2003, deadline. During this 254-day extension period, assessment and collection deadlines will be extended, and interest and penalties attributable to the extension period will not be charged. See Publication 3, Armed Forces' Tax Guide, for additional extension examples and computations of the extended due date.

Q-13: Assuming the same facts as in question 12, does the extension for filing and paying his individual income taxes apply to unearned income from my son's investments?

A-13: Yes. The deadline extensions apply without regard to the source of your son's income.

Q-14: Assuming the same facts as in question 12, will the deadline extensions continue to apply if my son is hospitalized as a result of an injury sustained in the combat zone?

A-14: Yes. The deadline extensions will apply for the period that your son is continuously hospitalized outside of the United States as a result of injuries sustained while serving in the combat zone, including 180 days thereafter. For hospitalization inside the United States, the extension period cannot be more than 5 years.

Q-15: My son is a member of a unit of the U.S. Armed Forces and most members of the unit have been serving in the combat zone since April 1, 2003. My son has been overseas since February 1, 2003, but he did not enter the combat zone until May 1, 2003. Is he entitled to an extension of time for filing and paying his 2002 federal income taxes?

A-15: No. Only a deadline arising on or after the date your son entered the combat zone, May 1, 2003, is postponed.

Q-16: Do the deadline extensions apply only to members of the U.S. Armed Forces serving in the combat zone?

A-16: No. Unlike the combat zone military pay exclusion discussed in Part 1, the deadline extensions also apply to individuals serving in the combat zone in support of the U.S. Armed Forces, such as merchant marines serving aboard vessels under the operational control of the Department of Defense, Red Cross personnel, accredited correspondents, and civilian personnel acting under the direction of the U.S. Armed Forces in support of those forces.

Q-17: Do the deadline extensions apply only to those inside of the combat zone?

A-17: No. Members of the U.S. Armed Forces who perform military service in an area outside the combat zone qualify for the deadline extensions if their service is in direct support of military operations in the combat zone, and they receive special pay for duty subject to hostile fire or imminent danger as certified by the Department of Defense. See Q & A-9 regarding certification by the Department of Defense.

Q-18: My son is a civilian explosive specialist who is in the combat zone training U.S. Armed Forces members serving in the combat zone. Do the deadline extension provisions apply to my son?

A-18: Yes. The deadline extensions apply to your son because he is serving in the combat zone in support of the U.S. Armed Forces.

Q-19: My husband is a private businessman working in the Arabian Peninsula Areas on nonmilitary projects. Do the deadline extensions apply to my husband?

A-19: No. Other than military members, the only individuals working in the combat zone that are entitled to the deadline extensions are those serving in support of the U.S. Armed Forces.

Q-20: I am a member of the U.S. Armed Forces serving in the combat zone. Do the deadline extensions apply to my husband, who is in the United States?

A-20: Yes. The deadline extensions apply not only to members serving in the U.S. Armed Forces (or individuals serving in support thereof) in the combat zone, but to their spouses as well, with two exceptions. First, if you are hospitalized in the United States as a result of injuries received while serving in the combat zone, the deadline extensions would not apply to your husband. Second, the deadline extensions for your husband do not apply for any tax year beginning more than 2 years after the date of the termination of the combat zone designation.

Q-21: Assuming the same facts as in question 20, will my husband have to file a joint tax return in order to benefit from the deadline extensions?

A-21: No. The deadline extensions apply to both spouses whether joint or separate returns are filed. If your husband chooses to file a separate return, he will have the same extension of time to file and pay his taxes that you have.

Q-22: My husband is serving in the U.S. Armed Forces in the combat zone. In 2002, our son, who is 12 years old, received interest income that is subject to income tax. Our daughter, who is 17 years old, received investment income. In addition, she received earned income from part-time work and is entitled to a refund. We claim both children as dependents on our joint income tax return. Must I file individual income tax returns for our children while my husband is in the combat zone?

A-22: No. Filing individual income tax returns for your dependent children is not required while your husband is in the combat zone. Instead, these individual income tax returns will be timely if filed on or before the deadline for filing your joint income tax return under the applicable deadline extensions. When filing your children's 2002 individual income tax returns, you should write "Combat Zone" in red at the top of those individual income tax returns. Because your older child may be entitled to a refund of tax, she may want to file her individual income tax return and obtain her refund without regard to the extension.

Q-23: I am a member of the U.S. Armed Forces serving in the combat zone. My spouse and our three children live in our home in the United States. During 2002, a child care provider took care of our children in our home. We are required to file a Schedule H, Household Employment Taxes, as an attachment to our joint income tax return to report the employment taxes on wages we paid to our child care provider. Do the deadline extensions apply to the filing of Schedule H as an attachment to our joint income tax return?

A-23: Yes. The deadline extensions apply to all schedules and forms that are filed as attachments to an income tax return.

Q-24: Almost two years ago, the IRS contacted me to collect tax on a joint income tax return I had filed with my now former spouse. I believe only my former spouse should be held liable for the tax. I understand that I may file Form 8857, Request for Innocent Spouse Relief, within 2 years of the first collection activity against me by the IRS. I have just entered a combat zone. Do the deadline extensions apply to the filing of Form 8857?

A-24: Yes. A list of time-sensitive acts for which performance is postponed for members of the U.S. Armed Forces (or individuals serving in support thereof) in a combat zone is provided in Rev. Proc. 2002-71, 2002-46 I.R.B. 850. Section 14.03(2) of that revenue procedure concerns innocent spouse relief.

Q-25: I served in the U.S. Armed Forces in Afghanistan from April 1, 2002, until August 31, 2002. I was reassigned to the Arabian Peninsula Areas on March 5, 2003. I understand that I was entitled to an extension of time for filing and paying my 2001

income taxes of 195 days (180 days plus the 15-day period that was left before the April 15, 2002 deadline). This extension period would have expired on March 14, 2003 -- 195 days from September 1, 2002 (my first day out of the combat zone in Afghanistan). What effect does my reentry into a combat zone have on my extension for filing and paying my 2001 income taxes?

A-25: Because the extension period had not expired for your 2001 individual income tax return before you reentered a combat zone, a new 180-day period will begin after you leave a combat zone for the second time. In addition, any time that remained in the 15-day period when you entered the Arabian Peninsula Areas adds to the new 180-day period when you leave the Arabian Peninsula Areas. In determining how much of the 15-day period is unused, treat the 180-day period as being used first. In your case, on March 5, 2003, 10 of the 15 days remained. After you leave the Arabian Peninsula Areas, you will have a 190-day extension period.

Q-26: My wife is a member of the U.S. Armed Forces serving in the combat zone. Can she make a timely qualified retirement contribution for 2002 to her individual retirement account (IRA) after April 15, 2003, and on or before the due date of her 2002 individual income tax return after applying the deadline extensions?

A-26: Yes. Your wife can make a timely qualified retirement contribution for 2002 to her IRA on or before the extended deadline for filing her 2002 income tax return under the deadline extensions.

Q-27: My brother, who began serving in the U.S. Armed Forces in the combat zone on January 10, 2003, did not make his fourth estimated tax payment for 2002 which was due January 15, 2003. Will my brother be liable for estimated tax penalties?

A-27: No. Your brother is covered by the deadline extensions and will not be liable for any penalties if he files and pays any tax due by his extended filing due date. When your brother files his 2002 individual income tax return, he should write "Combat Zone" in red at the top of that individual income tax return.

Q-28: My son, who is a member of the U.S. Armed Forces, was on an installment payment plan with the IRS for back income taxes before he was assigned to the combat zone. What should be done now that he is in the combat zone?

A-28: The IRS office where your son was making payments should be contacted. Because your son is serving in the combat zone, he will not have to make payments on his back income taxes for his period of service in the combat zone plus 180 days. No additional penalties or interest will accrue during the deadline extension period.

Q-29: My son, who is a member of the U.S. Armed Forces serving in the combat zone, will file his individual income tax return for 2002 after April 15, 2003, but on or before the end of the deadline extension for filing that return. He expects to receive a refund. Will the IRS pay interest on the refund?

A-29: Yes. The IRS will pay interest from April 15, 2003, on a refund issued to your son if he files his 2002 individual income tax return on or before the due date of that return after applying the deadline extension provisions. When your son files his 2002 individual income tax return, he should write "Combat Zone" in red at the top of that return. If his 2002 individual income tax return is not timely filed on or before the due date after applying the deadline extensions, no interest will be paid on the refund except as provided under the normal refund rules. Even though the deadline is extended, your son may file an individual income tax return earlier to receive any refund due.

Q-30: Do the deadline extensions apply to tax returns other than the individual income tax return?

A-30: Yes. The deadline extension provisions also apply to estate and gift tax returns. However, the deadline extensions do not apply to other tax and information returns, such as those for corporate income taxes, employment taxes, or excise taxes.

Q-31: My husband and I are civilian employees of defense contractors. I work in the United States and my husband temporarily works in Germany. Our jobs involve the production of equipment used by the U.S. Armed Forces for Operation Iraqi Freedom. Do the deadline extensions apply to either of us?

A-31: No. The deadline extensions do not apply to civilian employees of defense contractors unless they are serving in the combat zone in support of the U.S. Armed Forces.

PART 3 -- MISCELLANEOUS PROVISIONS

Q-32: My daughter is a member of the U.S. Armed Forces serving in the combat zone. She makes calls to me here in the United States. Are these calls exempt from the excise tax on toll telephone service?

A-32: Yes. Telephone calls that originate within the combat zone and that are made by members of the U.S. Armed Forces serving there are exempt from the excise tax on toll telephone service, provided a properly executed certificate of exemption is furnished to the telephone service provider receiving payment for the call. The exemption certificate should be in substantially the following form:

**EXEMPTION CERTIFICATE
(Overseas Telephone Calls)**

(Date).....20...

I certify that the toll charges of \$..... are for telephone or radio telephone messages originating at.....(Point of origin) within a combat zone from.....(Name) a member of the Armed Forces of the United States performing service in such combat zone; that the transmission facilities were furnished by(Name of carrier); and that the charges are exempt from tax under section 4253(d) of the Internal Revenue Code.

.....
 (Signature of Subscriber)

.....
 (Address)

Note: Penalty for fraudulent use: fine or imprisonment or both.

Q-33: If I already have paid an excise tax on the toll telephone service in Q & A-32, can I obtain a refund?

A-33: Yes. If you already have paid an excise tax on that toll telephone service, you may obtain a refund either from the telephone service provider that collected the excise tax, or from the IRS by filing Form 8849, Claim for Refund of Excise Taxes.

Q-34: How will my military pay for active service in the U.S. Armed Forces in the combat zone appear on my 2002 Form W-2, Wage and Tax Statement?

A-34: Military pay attributable to your active service in the combat zone that is excluded from gross income will not appear on your 2002 Form W-2 in the box marked "Wages, tips, other compensation." However, military pay for such service is subject to social security and medicare taxes and will appear on your 2002 Form W-2 in the boxes marked "Social security wages" and "Medicare wages and tips." If you believe you are entitled to the military pay exclusion, but the military pay exclusion is not reflected on your Form W-2, ask your service branch to issue a corrected Form W-2.

Q-35: I am an officer who served in the Operation Enduring Freedom combat zone from January 2002 until October 2002 and the Operation Iraqi Freedom combat zone from November 2002 through December 2002. I have made monthly contributions to an individual retirement account (IRA) for 2002. In view of the military pay exclusion for my service in the combat zones, I may have little or no taxable compensation for 2002 and may not be eligible to make an IRA contribution for 2002. If my taxable compensation is less than \$3,000 (\$3,500 if age 50 or older), should I withdraw the portion of my contributions that exceeds my taxable compensation?

A-35: Yes. In general, any amount contributed to your IRA that is more than the smaller of (1) your taxable compensation; or (2) \$3,000 (\$3,500 if age 50 or older), is an excess contribution and must be withdrawn to avoid a 6 percent excise tax. If you are married and file a joint income tax return, you may still be eligible to make an IRA contribution. See Publication 590, Individual Retirement Arrangements (IRAs), for more information on spousal contribution limits. Once you are sure that your taxable compensation will be less than \$3,000 (\$3,500 if age 50 or older), you should withdraw the portion of your contributions that exceeds your taxable compensation. You will not be taxed on the distributed amount if you receive the distribution on or before the deadline for filing your 2002 individual income tax return after applying the deadline extension provisions. You may not take a deduction with respect to these distributed contributions. You must also withdraw the amount of net income attributable to the distributed contributions while

they were assets of the IRA. That portion of the net income is includible in your gross income for 2002. For further information, see Publication 590, Individual Retirement Arrangements (IRAs).

Q-36: Assuming the same facts as in question 35, how will the financial institution that distributes my 2002 IRA contributions to me report this distribution?

A-36: The financial institution will report the entire amount of the distribution (2002 distributed contributions and attributable net income) on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. However, it should report only the amount of any net income attributable to the distributed contributions as the "Taxable amount" on Form 1099-R.

Q-37: How might my combat zone military pay exclusion affect my eligibility for the Earned Income Credit (EIC)?

A-37: A change in the tax law for 2002 and later years removes from the definition of "earned income" for purposes of the EIC all employee compensation that is not includible in gross income for the tax year. Thus, for example, excludable combat zone compensation no longer counts as earned income. Also excluded from earned income are the Basic Allowance for Housing (BAH) and the Basic Allowance for Subsistence (BAS). With this change, your income may fall within the qualifying range to claim the credit. But if the exclusion leaves you with no earned income, you will not be able to claim the EIC. See Publication 3, Armed Forces' Tax Guide, for details.

PART 4 – INQUIRIES

The IRS Web site at www.irs.gov offers tax information for Armed Forces members (and those serving in support of the Armed Forces) -- search for "Armed Forces" on the site.

The IRS has a special e-mail address -- combatzone@irs.gov -- for taxpayers in a combat zone to send questions specifically related to filing and payment issues and to update their combat zone status in order to qualify for relief provisions. The Web site has more information about this service and restrictions on IRS responses that would include tax account information.

Taxpayers within the United States may seek assistance by calling the IRS at 1-800-829-1040 (toll-free). Taxpayers outside the United States may contact the IRS in Philadelphia, PA, at (215) 516-2000 or via fax at (215) 516-2555 (these are not toll-free numbers).

The IRS offices in Italy, Germany, France, England, Japan, and Singapore, can also assist you with your federal income tax questions. The Singapore office will close after June 30, 2003. You may contact the Rome office at [39] (06) 4674-2560, or via fax at [39] (06) 4674-2223; the Berlin office at [49] (30) 8305-1136 and [49] (30) 8305-1140, or via fax at [49] (30) 8305-1145; the Paris office at [33] (1) 4312-2555, or via fax at [33] (1) 4312-4752; the London office at [44] (207) 408-8077, or via fax at [44] (207) 495-

4224; the Tokyo office at [81] (3) 3224-5466, or via fax at [81] (3) 3224-5274; and the Singapore office at [65] 6476-9413 or via fax at [65] 6476-9030.