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Armed Forces' Tax Guide

For use in preparing
2004 Returns

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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.

TIP *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, see Publication 519.

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

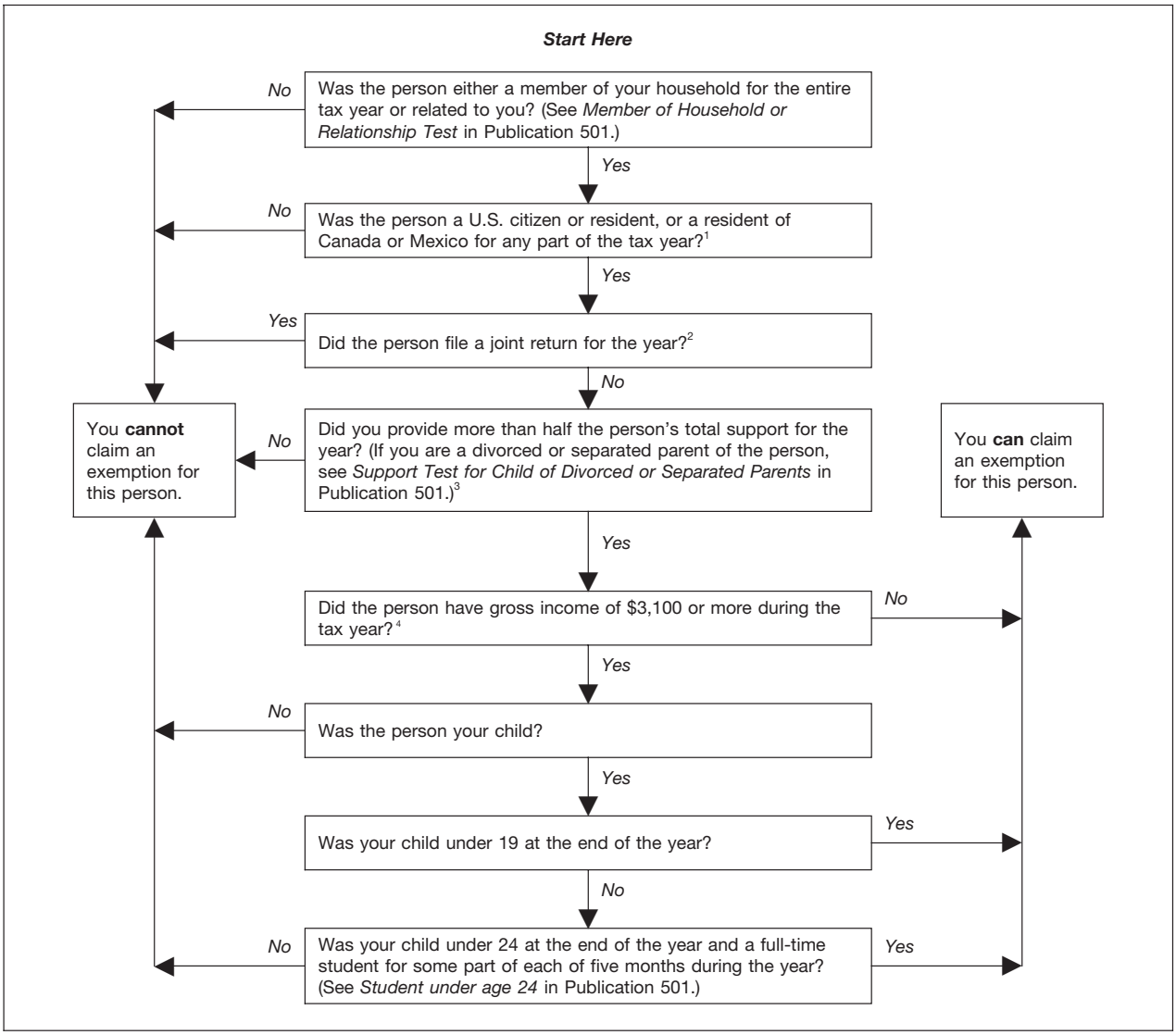
Exemptions reduce your income before you figure your tax. There are two types of exemptions.

- 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

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.)

one exemption for each person qualifying as your dependent who meets five specific tests.

TIP *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 2004, you generally can deduct $3,100 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.

CAUTION *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 $3,100. 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 2004 and entered the U.S. Air Force in September 2004. 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 2004 because they did not provide more than half her support.

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 2004

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 2004. 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 1996. 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 2004. 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 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. Returns filed before they are due are considered filed on the due date, usually April 15.

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 2004, 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 (Form 2119, line 14).

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 2004. In January 2004, 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 2004. For everyone else who sold a home before May 7, 1997, the replacement period ended before 2004.

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 April 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, 2003. The suspension period will expire October 31, 2004. 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 7½-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 4, 2002, after the end of the 180-day period (January 5, 2002, to July 3, 2002) 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 3, 2004 (27 months after July 3, 2002).

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 (Form 2119, line 14), and
- Any fixing-up expenses you had (Form 2119, line 10).

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.
- 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 (Form 2119, line 14).

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 *Determining 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 *Deducting Taxes in the Year of Sale*, 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 Form 2119, page 1, 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 5 years while Frank was outside the United States on extended active duty with the Armed Forces.

On April 20, 2004, (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		18,800
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)]		4,100
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		14,700
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		$62,500

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, see 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, see 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, see Publication 529.

Employee Business Expenses

Deductible employee business expenses are miscellaneous itemized deductions subject to the 2% limit. For information on employee business expenses, see 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 Form W-2, box 1 are not considered reimbursements).
- If you claim car expenses, you use the standard mileage rate.

For 2004, the standard mileage rate is 37.5 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, see 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 2004.
2. Your earned income and adjusted gross income (AGI) must each be less than:
   a. $34,458 ($35,458 for married filing jointly) if you have two or more qualifying children, or
   b. $30,338 ($31,338 for married filing jointly) if you have one qualifying child.
3. Your filing status cannot be married filing separately.
4. You cannot be a qualifying child of another person. If filing a joint return, your spouse also 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 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. If you need more information about making this choice, see *Resident Aliens*, earlier.

8. Your investment income must be $2,650 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 Form 1040, line 37, or Form 1040A, line 21.

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 2004, 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 65a (Form 1040) or line 41a (Form 1040A) if you cannot claim the credit because:

- Your earned income was $30,338 ($31,338 for married filing jointly) or more if you have one qualifying child, or $34,458 ($35,458 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 2004,
- 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 2004 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.
- 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 2004.
2. Your earned income and adjusted gross income must each be less than $11,490 ($12,490 for married filing jointly).
3. Your filing status cannot be married filing separately.
4. You cannot be a qualifying child of another person. If filing a joint return, your spouse also cannot be a qualifying child of another person. See *Qualifying child of another person*, earlier.
5. You must be at least age 25 but under age 65 at the end of your tax year. If filing a joint return, either you or your spouse must be at least age 25 but under age 65 at the end of your tax year.
6. You cannot be claimed as a dependent by anyone else on that person's return. If filing a joint return, your spouse also 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 $2,650 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 65a (Form 1040), next to line 41a (Form 1040A), or on line 8a (Form 1040EZ) if you cannot claim the credit because:

- Your earned income was $11,490 ($12,490 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 2004, 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 the following.

- Wages, salaries, and tips.
- Net earnings from self-employment.
- Gross income received as a statutory employee.
- Nontaxable combat pay if you elect to include it in earned income. See *Nontaxable combat pay election*, later.

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.

Nontaxable combat pay election. You can elect to have your nontaxable combat pay included in earned income for the earned income credit. Electing to include nontaxable combat pay in earned income may increase or decrease your EIC. Figure the credit with and without your nontaxable combat pay before making the election. If you make the election, you must include in earned income all nontaxable combat pay you received. The amount of your nontaxable combat pay should be shown on your Form W-2, in box 14, with Code Q.

See the instructions for the form you are using (Form 1040, Form 1040A, or 1040EZ).

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 2005.

- You must work and expect that your earned income and AGI will each be less than a certain amount. The amount in 2004 was $30,338 ($31,338 for married filing jointly). The amount for 2005 will be higher. See the 2005 Form W-5, Earned Income Credit Advance Payment Certificate, for the 2005 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 2005, you can choose to get part of the credit in advance by giving a completed 2005 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 2004, you must file either Form 1040 or Form 1040A for 2004 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 2004.
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 2004 is considered to have lived with you for all of 2004 if your home was the child's home for the entire time he or she was alive during 2004.

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 Form 1040, line 45, or Form 1040A, line 28, 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 Form 1040, line 37, or Form 1040A, line 21.

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 Form 1040, line 51, or Form 1040A, line 33, 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 (Form 1040 instructions, page 38).
3. If you have an additional child tax credit on Form 8812, line 13, carry it to Form 1040, line 67, or Form 1040A, line 42.

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, see 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. No tax liability will be imposed on the beneficiary or trustee of the estate of a deceased individual to the extent the liability is attributable to an amount received that would have been includible in the individual's gross income for the taxable year in which the date of death falls (determined as if the individual had survived).

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.

TIP *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.

No tax liability will be imposed on the beneficiary or trustee of the estate of a deceased individual to the extent the liability is attributable to an amount received that would have been includible in the individual's gross income for the taxable year in which the date of death falls (determined as if the individual had survived).

Example. Army Private John Kane died in 2004 of wounds incurred in a terrorist attack in 2003. His income tax liability is forgiven for all tax years from 2002 through 2004. 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. Returns filed before they are due are considered filed on the due date, usually April 15.

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

Designated private delivery services include only the following.

- DHL Express (DHL): DHL Same Day Service, DHL Next Day 10:30 am, DHL Next Day 12:00 pm, DHL Next Day 3:00 pm, and DHL 2nd Day Service.
- 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 2004 tax returns, the due date is April 15, 2005.

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 Form 1040, line 68. 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 15, 2005, by filing a paper Form 4868 by June 15, 2005, for a 2004 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, 2004) to file your 2003 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, 2004) are added to the 180 days when determining the last day allowed for filing your 2003 tax return.

Example 1. Captain Margaret Jones entered Saudi Arabia on December 1, 2002. She remained there through March 31, 2004, 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' 2002, 2003, and 2004 returns are figured as follows.

The 2002 tax return. The deadline is January 10, 2005. This deadline is 285 days (180 plus 105) after Captain Jones' last day in the combat zone (March 31, 2004). 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, 2003).

The 2003 tax return. The deadline is January 10, 2005. The deadline is 286 days (180 plus 106) after Captain Jones' last day in the combat zone (March 31, 2004).

The 2004 tax return. The deadline is not extended because the 180-day extension period after March 31, 2004, ends on September 27, 2004, which is before the start of the filing period for her 2004 return (January 1 – April 15, 2005).

Example 2. Petty Officer Leonard Brown's ship entered the Persian Gulf on January 5, 2003. On February 15, 2003, Leonard was injured and was flown to a U.S. hospital. He remained in the hospital through April 21, 2004. The deadlines for filing Petty Officer Brown's 2002, 2003, and 2004 returns are figured as follows.

The 2002 tax return. The deadline is January 27, 2005. Petty Officer Brown has 281 days (180 plus 101) after his last day in the hospital (April 21, 2004) to file his 2002 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, 2003).

The 2003 tax return. The deadline is February 1, 2005. Petty Officer Brown has 286 days (180 plus 106) after April 21, 2004, to file his 2003 tax return. The 106 additional days are the number of days in the 2004 filing period that were left when he entered the combat zone.

The 2004 tax return. The deadline is not extended because the 180-day extension period after April 21, 2004, ends on October 18, 2004, which is before the start of the filing period for his 2004 return (January 1 – April 15, 2005).

Example 3. You generally have 3 years from April 15, 2001, to file a claim for refund against your timely filed 2000 tax return. This means that your claim normally must be filed by April 15, 2004. However, if you served in a combat zone from November 1, 2003, through March 23, 2004, and were not injured, your deadline for filing that claim is extended 347 days (180 plus 167) after you leave the combat zone. This extends your deadline to March 5, 2005. The 167 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, 2003 – April 15, 2004).

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

Request for deferment. If you have a current payment agreement (such as an installment 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 "Servicemembers 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 2004 return is due by the regular due date, April 15, 2005 (June 15, 2005, 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 *www.irs.gov/advocate*.

For more information, see Publication 1546, The Taxpayer Advocate Service of the IRS—How To Get Help With Unresolved Tax Problems.

Free tax services. To find out what services are available, get Publication 910, IRS 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 website 24 hours a day, 7 days a week, at *www.irs.gov* to:

- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Check the status of your 2004 refund. Click on *Where's My Refund*. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2004 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 online.
- Research your tax questions online.
- Search publications online by topic or keyword.
- View Internal Revenue Bulletins (IRBs) published in the last few years.
- Figure your withholding allowances using our Form W-4 calculator.
- Sign up to receive local and national tax news by email.
- Get information on starting and operating a small business.

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 the telephone connected to your fax machine. When you call, you will hear instructions on how to use the service. 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/localcontacts* 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 questions or to order forms and publications.
- *TeleTax topics.* Call 1-800-829-4477 and press 2 to listen to pre-recorded messages covering various tax topics.
- *Refund information.* If you would like to check the status of your 2004 refund, call 1-800-829-4477 and press 1 for automated refund information 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). Have your 2004 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/localcontacts* 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 business days 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 Publication 1796, IRS Federal Tax Products 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, or saved for recordkeeping.
- Internal Revenue Bulletins.

Buy the CD-ROM from National Technical Information Service (NTIS) 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. Publication 3207, The Small Business Resource Guide, CD-ROM 2004, 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 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 *www.irs.gov/smallbiz*.

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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.

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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 2005
553 Highlights of 2004 Tax Changes
910 IRS 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)
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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 Health Savings Accounts and Other Tax-Favored Health Plans
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—How to Get Help With Unresolved Problems

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
1040 U.S. Individual Income Tax Return	11320
Sch A&B Itemized Deductions & Interest and Ordinary Dividends	11330
Sch C Profit or Loss From Business	11334
Sch C-EZ Net Profit From Business	14374
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Sch D-1 Continuation Sheet for Schedule D	10424
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2441 Child and Dependent Care Expenses	11862
2848 Power of Attorney and Declaration of Representative	11980
3903 Moving Expenses	12490
4562 Depreciation and Amortization	12906
4868 Application for Automatic Extension of Time To File U.S. Individual Income Tax Return	13141
4952 Investment Interest Expense Deduction	13177
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8283 Noncash Charitable Contributions	62299
8582 Passive Activity Loss Limitations	63704
8606 Nondeductible IRAs	63966
8812 Additional Child Tax Credit	10644
8822 Change of Address	12081
8829 Expenses for Business Use of Your Home	13232
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