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BAUCUS-GRASSLEY BILL OFFERS TAX RELIEF TO AMERICA'S FIGHTING MEN AND WOMEN

Legislation extends, streamlines and strengthens provisions to aid U.S. troops

Washington, DC **–** U.S. Senators Max Baucus (D-Mont.) and Chuck Grassley (R-Iowa), Chairman and Ranking Republican Member of the Senate Finance Committee, today led a dozen fellow Senators in introducing legislation to provide significant tax cuts for American troops and their families. The Defenders of Freedom Tax Relief Act helps members of the military when they receive combat pay, save for retirement, or purchase their own homes. The bill also includes tax help for employers of military reservists and for members of the National Guard who provide assistance to employees who are called to active duty.

"I introduced this legislation out of deep respect for our nation's military. This bill honors and values the sacrifices that the men and women of the armed services make for our country every single day," said Baucus. "**This legislation puts dollars in the pockets of soldiers and veterans, and gets rid of unnecessary tax restrictions for military families who have more important things to worry about than red tape. There are often no words to express our thanks, but it is my hope this bill will show our troops that we recognize their contributions to our freedom."**

Grassley said, **"Military service makes taxes complicated and sometimes unfair. People shouldn't suffer a tax hit to serve our country. We need to make sure military men and women have fair treatment under the tax code. It's a no-brainer."**

The Senators' bill includes more than $550 million in tax relief for veterans, soldiers and their employers. Provisions in the legislation will:

- Make permanent a provision that allows soldiers to count their non-taxable combat pay when figuring their eligibility for the earned income tax credit, a refundable federal income tax credit that puts cash in the hands of low-income working individuals and families.

- Allow all veterans—not just first-time homebuyers—to use qualified mortgage bonds to purchase their homes

- Cut taxes for small businesses when they continue paying some salary to members of the National Guard and Reserve who are called to duty

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- Eliminates cumbersome rules for reporting of income when companies continue paying some salary to members of the National Guard and Reserve who are called to duty. This makes it easier for reservists to file their taxes and simpler for employers to keep contributing to those employees' retirement plans.

- Allow the families of soldiers killed in the line of duty to contribute up to 100 percent of survivor benefits to a retirement savings account

- Allow active duty troops to withdraw money from retirement plans and give them two years to replace the funds without tax penalty

- Extend a provision that gives retired veterans more time to claim a tax refund on some types of disability benefit payments

- Make permanent a provision that gives intelligence service employees a longer period of time to meet residency requirements necessary to exclude profits from the sale of their home from capital gains tax, which is often necessary due to frequent deployment

- Give the IRS the authority to treat gifts of thanks from states to veterans—such as payments of excess state revenue—as nontaxable gifts

More details on the bill's provisions and their costs can be found on the Finance Committee website by clicking here. See below for a short summary.

The bill is paid for with two offsets. The first makes certain that individuals who relinquish their U.S. citizenship or long-term U.S. residency pay the same Federal taxes for appreciation of assets, such as stocks or bonds, that they would pay if they sold them as U.S. citizens or residents. The second extends a provision that allows the Social Security Administration to share earnings information so that accurate amounts of pension, dependency and indemnity compensation, hospice care, or unemployment compensation is paid to veterans and their families.

Additional sponsors of the bill include Senators Jay Rockefeller (D-W.Va.), Kent Conrad (D-N.D.), Jeff Bingaman (D-N.M.), Olympia Snowe (R-Maine), John Kerry (D-Mass.), Blanche Lincoln (D-Ark.), Gordon Smith (R-Ore.), Chuck Schumer (D-N.Y.), Debbie Stabenow (D-Mich.), Maria Cantwell (D-Wash.), Pat Roberts (R-Kan.), and Ken Salazar (D-Colo.). A number of elements in the bill mirror or build on provisions proposed by members of the Finance Committee, including Rockefeller, Kerry, Lincoln, and Smith. The Committee, which has jurisdiction over tax policy, will formally consider the Defenders of Freedom Tax Relief Act this month.

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DEFENDERS OF FREEDOM TAX RELIEF ACT OF 2007

Title	Description	10-Year Cost
1. Expansion of qualified mortgage bond program for veterans	Qualified mortgage bonds may be issued to finance mortgages for veterans who served in active military without regard to the first-time homebuyer requirement. This exception to the first-time homeownership requirement expires on December 31, 2007. The proposal would extend this provision for three years. Veterans may use the exception one time only. Present law income and purchase price limitations would continue to apply to loans to veterans financed with the qualified mortgage bond proceeds. Veterans would be eligible without regard to the date they last served on active duty.	$ 431 M
2. Permanent extension of election to include combat pay as earned income for EITC	Combat pay is not subject to income tax. However, this provision can lead to lost tax benefits for lower-income service people because the earned income tax credit (EITC) requires some taxable income in order to qualify. A change to EITC was enacted that allows service people to elect to include their combat pay as earned income for purposes of EITC. This provision expires on December 31, 2007. The proposal would make this election permanent.	$ 83 M
3. Extension of the statute of limitations when military retired pay is reduced as a result of award of disability compensation	Most VA disability claims filed by military retirees are resolved in less than a year. But lost paperwork, administrative errors, and appeals of rejected claims delay thousands of disability awards for years. The VA disability award is retroactive to the date of the application and makes a portion of past military retired pay tax-free. But to claim a tax refund, disabled veterans must file an amended tax return for each applicable year. The statute of limitations for filing a tax refund expires generally after three years from the date of filing the tax return. As a result, disabled veterans are barred from receiving tax refunds through no fault of their own. The proposal extends the statute of limitations until the end of the 1-year period beginning on the date of the VA disability determination.	$ 10 M

4. Differential military pay treated as a payment of wages	When a National Guardsman or Reservist is called up to active duty, their civilian job and civilian salary are placed on hiatus and they begin receiving military pay - an amount which may be significantly less than their civilian salary. There are currently many employers who voluntarily eliminate any pay gap by paying the difference. Currently the IRS treats these differential pay payments as benefits requiring reporting on the Form 1099. This is a burden for the employee and the employer. The proposal would treat the differential pay payments as wages requiring the information reporting on the more easily accessible Form W2 and subject the differential pay payments to withholding. The proposal would also make it easier for employers to contribute to their activated employee's retirement plans while the employees are serving in active duty.	$ 8 M
5. Tax credit for small employers of Employee Reservists and National Guardsmen called for active duty	This proposal would provide an incentive for small employers to eliminate any pay gap existing for reservist/employees between civilian and military pay. The proposal would provide small businesses of less than 50 employees a tax credit up 20% of the differential pay (up to $20,000) that the employer pays to any employee who is called up for active duty.	$ 9 M
6. Penalty-free withdrawals from retirement plans for reservists called to active duty	Generally, a taxpayer who receives a distribution from a qualified retirement plan prior to age 59 ½ is subject to a 10-percent early withdrawal tax. In 2006, an exception to this 10-percent early withdrawal tax was provided for qualified reservists called to active duty for at least 179 days. Under this exception, the reservist may make an early withdrawal from a retirement plan without triggering the withdrawal tax and the reservist has two-years from the last day of the active duty period to contribute distributions to an IRA. This exception expires on December 31, 2007. The proposal would make this exception permanent.	$ 6 M
7. Roll-over of military death gratuities to tax-favored accounts	The Defense Department provides $100,000 payments to the survivors of soldiers killed in the line of duty. However, restrictions exist limiting a survivor's ability to contribute his or her gratuity payment to certain tax favored accounts. The proposal would allow survivors to contribute any amount up to the sum of the gratuity payment into a Roth IRA account.	$ 3 M

8. Exclusion of gain from sale of principal residence for intelligence service employees	Current law provides an exclusion from capital gains tax of $250,000 ($500,000 for married couples) from the sale of a primary residence if the taxpayer owned and lived in the residence for at least 2 of the 5 years. In 2003, Congress changed the law to permit military service personnel and foreign service officers to toll the 5-year period for up to 10 years while they are stationed 50 miles from home. In 2006, the same residency requirement exception was extended to intelligence service employees, except that it requires that the intelligence officers be stationed overseas. The intelligence community provisions expire on December 31, 2010. The proposal would make the exception permanent. Also this proposal would no longer require intelligence officers to be stationed overseas in order to make use of the residency requirement exception. This would provide equal treatment to military service personnel, foreign service officers, and intelligence officers.	$ 3 M
9. Treat State payments to service members as nontaxable gifts	States often pay excess state revenue to service members as thanks for their war service. Gifts are not subject to income tax. Courts have defined a gift as payments proceeding out of “detached and disinterested generosity” and not any “moral or legal duty” or “from an incentive of anticipated benefit.” The IRS currently treats payments made by a State to or on behalf of veterans who served in war as nontaxable gifts but the IRS lacks statutory authority for this treatment. This provision would codify IRS practice.	Negligible Revenue Effect

Revenue Offsets		
1. Market-to-Market tax on Individuals who expatriate	Current tax rules for individuals who relinquish their U.S. citizenship or long-term U.S. residency are difficult to administer and the taxes are drawn out over 10 years. The proposal would impose a new 'mark-to-market' tax on certain U.S. citizens and long-term residents who terminate their U.S. residence. In general, such individuals would be taxed on the net unrealized gain in their property, as if such property were sold for fair market value (hence, mark-to-market) on the day prior to the expatriation or the U.S. residency termination. Any loss from the deemed sale generally would be taken into account to the extent otherwise provided in the tax code. Any net gain on the deemed sale is recognized to the extent it exceeds $600,000.	$ 444 M
2. Allow the SSA to disclose return information to the VA	Current law allows the Social Security Administration to disclose tax return information regarding net earnings for purposes of verifying any needs-based pension, dependency and indemnity compensation to parents of a deceased veteran, hospice care, or certain unemployment compensation. This provision expires on September 30, 2008.	$ 164 M