



TAX ALERT: NEW TAX BREAK FOR FOREIGN SERVICE & MILITARY HOMEOWNERS

Since 1997 the law has permitted homeowners to exclude profits on the sale of their principal residence if they have owned and lived in the property an aggregate of two years over the last five years. There was no exception for Foreign Service or military personnel.

Now the President has signed H.R. 3365, the "Military Tax Relief Act of 2003" to provide special rules for members of the uniformed services and Foreign Service. The bill amends Section 121 of the Internal Revenue Code to suspend, for a maximum of ten years, the running of the five-year period while the taxpayer or their spouse is "serving on qualified official extended duty as a member of the uniformed services or the Foreign Service." The term "qualified official extended duty" means "any extended duty while serving at a duty station which is at least 50 miles from such property or while residing under Government orders in Government quarters". The term "extended duty" means any period of active duty for a period in excess of 90 days or for an indefinite period.

Foreign Service and military personnel qualify for the exclusion of profits on their sale if they have owned and lived in the property for a period of two years over the last five years plus the period suspended while on "qualified extended official duty". The property may currently be a rental.

Example: A Foreign Service officer or military couple purchases a home in June 1996. They live there until September 1998. They then transfer to a new duty station where they are still serving. The house has been rented. They wish to sell the house in January 2004. Will they qualify for the exclusion of gain?

Yes: They used the house as their principal residence for two years, and since they were "serving on qualified official extended duty," up to ten of the years between September 1998 and January 2004 would be suspended.

If the owner qualifies, then profit from the sale of the house up to \$250,000 if single, or up to \$500,000 if married and filing a joint return, will be excluded from income. The only taxable income would be the recapture of depreciation taken on the house since May 6, 1997.

The change would be optional and retroactive to 1997. If a military or Foreign Service taxpayer has paid the capital gains tax because they did not previously qualify, they may file an amended return on IRS Form 1040X to obtain a refund. Even if the time period for filing an amended return for the year the tax was paid has passed, the new law permits a claim to be submitted regardless for a one-year period ending November 10, 2004. Affected military or Foreign Service personnel should contact their tax advisor as soon as possible.

If the owner of a rental property does not qualify for the exclusion, they can still do a tax-deferred like-kind exchange. This permits them to defer all of the capital gain (profit and depreciation) to a new property to be held for investment, business or rental. There are specific reinvestment requirements and time limits involved for the exchange to be totally tax free.

This publication is designed to provide accurate information on tax-deferred exchanges. The publisher is not engaged in rendering legal or accounting services. If legal or tax advice is required, the services of a competent professional should be sought.

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