



COMBAT ZONE TAX EXCLUSION

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★ WHAT IT MEANS FOR YOU

The Combat Zone Tax Exclusion (CZTE) is a provision that exempts all or a portion of earnings from federal income taxes while an active duty Service member is deployed to a designated combat zone. This can mean more money in your pocket and an opportunity to achieve financial goals like paying off debt and saving for retirement.

★ HOW DOES IT WORK?

In most cases, if your Service member is serving one or more days in a designated combat zone, federal income taxes are excluded on the following military compensation:

- **Basic Pay** — Every month your Service member is present in a combat zone with some exceptions.
- **Incentive Bonuses or Continuation Pay** — Your Service member can exclude this income if the reenlistment or the execution of the contractual agreement for continued service occurs while present in a combat zone.
- **School Loan Repayments** — Your Service member can exclude part of the repayment associated with the months they were present in a combat zone. For example, if a year is required to earn the repayment and your Service member serves six of those months in a combat zone, they can exclude half of their repayment income.
- **Imminent Danger/Hostile Fire Pay** — Your Service member can exclude all of this income.
- **Leave Benefits** — Your Service member can exclude income from selling accrued leave earned while in a combat zone.
- **Awards and Other Financial Incentives** — Your Service member can exclude associated income for submissions made while in a combat zone.

Your Service member does not have to do anything to sign up or enroll. It is automatically reflected on their LES and W-2. Review both for confirmation.

Income earned while hospitalized as the result of an injury sustained in a combat zone is tax-exempt. Medicare and Social Security taxes are still applicable.

★ WHOM DOES IT IMPACT?

- CZTE is unlimited for enlisted Service members and warrant officers.
- Pay for some officers is excluded to the maximum rate for enlisted members plus imminent danger or hostile fire pay. In 2020, the maximum exclusion was \$8,844.30 per month.

★ THRIFT SAVINGS PLAN (TSP) LIMITS

The maximum contribution (called the elective deferral) to a Thrift Savings Plan account is \$19,500 and the catch-up provision for those over 50 is \$6,500 (2021). Additionally, your Service member can contribute up to the annual limit of \$58,000, but any amount over the elective deferral is considered a Traditional contribution and its earnings will be taxed at withdrawal.

If your Service member is covered under the BRS, their automatic (1%) and service matching contributions (4%) apply to the annual limit and are treated as Traditional contributions, which will be taxed upon withdrawal.

★ ROTH IRA LIMITS

The maximum contribution to an IRA is \$6,000 plus \$1,000 catch up for those over 50 (2021). Under the CZTE, you can make this Roth contribution with your tax-exempt income.

Remember, in the case of the TSP and Roth IRA, these are retirement accounts. Your Service member cannot access this money until the age of 59½ without penalty and tax consequences.

★ SPECIAL CONSIDERATIONS FOR RETIREMENT ACCOUNTS

Typically, contributions to a Roth IRA are after-tax and withdrawals are tax-free (additional rules may apply). If your Service member qualifies for the CZTE, their Roth contributions to the TSP and/or a Roth IRA will be made with income that has **not** been taxed when earned and **will not** be taxed at withdrawal. It is a huge opportunity to boost retirement savings!

★ WANT TO LEARN MORE? CHECK OUT THESE RESOURCES!

- IRS Guidelines: <https://www.irs.gov/individuals/military/tax-exclusion-for-combat-service>
- IRS Publication 3, Armed Forces' Tax Guide: <https://www.irs.gov/forms-pubs/about-publication-3>
- DoD Definition: <https://militarypay.defense.gov/Pay/Tax-Information/CZTE/>
- Military Pay Tables: <https://www.dfas.mil/militarymembers/payentitlements/Pay-Tables/>
- Combat Zones: <https://www.dfas.mil/militarymembers/payentitlements/Pay-Tables/CZ1/>
- TSP Limits: <https://www.tsp.gov/making-contributions/contribution-limits/>