



LEGAL ASSISTANCE PRACTICE ADVISORY

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Code 16 POCs

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Subj: New Tax Law Regarding Spouse Legal Residence/Domicile; Warning: Rocks and Shoals Ahead!

1. **A New Tax Benefit – “Use Carefully, May Cause Headaches Before Providing Relief!”** Like those disclaimers for prescription medication ads, a new law needs plenty of fine print to make sure it is used correctly and by military families who actually qualify for the benefit. Senate Bill 475 was signed by the President on Veterans Day, November 11th, and is effective for 2009. This law, now officially Public Law 111-97, is known as the “Military Spouses Residency Relief Act.” It amends the Servicemembers Civil Relief Act (SCRA) to provide, among other things, the ability for *some* military spouses to regain a “lost” domicile for tax purposes. Sounds great, right? But wait, there’s more, much more!

2. **What the Law Really Says.** Some media accounts of this law have been misleading or incomplete. This law does not simply permit a non-military spouse to “pick or choose” a legal domicile in a State that, for example, does not have a State income tax. In fact, P.L. 111-97 states that:

“A spouse of a servicemember shall neither lose nor acquire a residence or domicile for purposes of taxation [personal, income or personal property] ... by reason of being absent or present in any tax jurisdiction of the United States solely to be with the servicemember in compliance with the servicemember’s military orders if the residence or domicile ... is the same for the servicemember and the spouse.”

There are a few critical pieces to this seemingly simple legislation that will be discussed below. But to truly understand P.L. 111-97, we need to have a refresher on the SCRA protections for active duty military servicemembers.

a. **SCRA Tax Protections.** As used in the SCRA, the terms "legal residence" and "domicile" are essentially interchangeable. These terms are used to denote that place where a servicemember has his/her permanent home and to which, whenever they are absent, they have the intention of returning. The SCRA protects military pay from the income taxes of the State in which a servicemember resides by reason of military orders unless that State is also their legal residence/domicile. The SCRA further provides that no change in your State of legal residence/domicile will occur solely as a result of being ordered to a new duty station.

b. It is well known that military members have a propensity for becoming a legal domiciliary of such tax-free States as Texas, Florida, Washington, Nevada,

Alaska, South Dakota, and Wyoming, not to mention other tax-favored States such as New Hampshire and Tennessee. Some military members actually are natives of these States and proudly retain their connections to home. Others become so enamored of these States that, when opportunity permits, establish a new legal domicile and abandon their legal ties to their prior legal home.

c. The servicemember's establishment of a new legal domicile in the new State is accomplished by several actions. At a minimum, the servicemember completes a DD Form 2058, "State of Legal Residence Certificate" and files it with their personnel office. This Form will serve to change the tax withholding State on the Leave and Earnings Statement. However, this Form does NOT, by itself, serve to legally change the servicemember's State of legal residence/domicile. As set forth above, the definition of legal residence/domicile for SCRA purposes is the place where a servicemember has his/her permanent home and maintains an intent to return to that State while absent from that State due to military orders. This is not accomplished merely by filing a DD Form 2058 with the personnel office.

c. In its own instructions, DD Form 2058 provides a good description of the general rules on establishing a new legal residence/domicile.

i. "The formula for changing your State of legal residence/domicile is simply stated as follows: physical presence in the new State with the simultaneous intent of making it your permanent home and abandonment of the old State of legal residence/domicile. In most cases, you must actually reside in the new State at the time you form the intent to make it your permanent home. Such intent must be clearly indicated."

ii. The instructions go on to state that a servicemember's intent to make the new State their permanent home may be indicated by certain actions such as:

"(1) registering to vote; (2) purchasing residential property or an unimproved residential lot; (3) titling and registering your automobile(s); (4) notifying the State of your previous legal residence/domicile of the change in your State of legal residence/domicile; and (5) preparing a new last will and testament which indicates your new State of legal residence/domicile."

iii. The final caveat is that the servicemember "must comply with the applicable tax laws of the State which is your new legal residence/domicile."

3. What the Law Really Means. The Congressional intent for P.L. 111-97 was to equate military spouses with their servicemember spouses for purposes of taxation [several other aspects of the law are ignored here to avoid further confusion] to "reduce some of the confusion, difficulties, and burdens now faced by military families when they are moved to a new state." Senate Report 111-46 at page 6. While this intent is laudable, those of us who will be advising clients on the implications of this new law may find that it in fact adds "confusion, difficulties, and burdens!"

a. Boiled down to its essence, P.L. 111-97 says that if a military member is entitled to SCRA legal residence/domicile tax protection, their spouse is entitled to the same protection for the same legal residence/domicile of the military spouse *if the spouse had previously acquired that same legal residence/domicile*. For example, a Sailor who, while in training in Pensacola, files a Form DD-2058 changing their residence from Virginia to Florida, and does some or all of the other things which demonstrate intent to become a legal Florida domiciliary, is thereafter no longer subject to Virginia income or personal property tax, even if later stationed in Virginia.

b. Prior to the passage of P.L. 111-97, the servicemember's spouse had no such lawful right and his/her legal domicile changed with every PCS move, at least to the extent that they earned income in the new State, or were required by State law to get a new driver's license or other documents.

c. The effect of the new law is that the spouse who also once acquired legal residence/domicile in their servicemember/spouse's state of legal domicile no longer loses the right to maintain that domicile. In our example, if our Sailor was married at the time he/she established Florida domicile, his/her spouse would be able to "reach back" and reclaim their own long-lost Florida legal domicile and apply it in 2009 to income earned in their duty station State. On the other hand, if the spouse had no connections at all to Florida (*i.e.*, never acquired legal residence in the State), he or she does not now have the ability to claim legal Florida residence/domicile. *In short, you can't gain or lose what you never had.*

i. To continue our example, the now dual Florida legal resident couple is stationed in Virginia. The spouse works outside of the home in Virginia and was a Virginia resident for 2008, filing a Virginia tax return and paying Virginia taxes. One of their vehicles is titled in the non-military member's name and was subject to personal property tax in their county of (temporary) residence. For 2009 the spouse can now claim that he/she is a non-resident of Virginia and seek a total refund of income and personal property taxes. In an odd twist of the law, if the military member had a moonlighting job in Virginia, that income would be subject to Virginia tax, but not the military or spousal income!

ii. If the couple in our example do not both qualify as legal Florida residents/domiciliaries, the tax situation does not change for them for 2009. The non-military spouse cannot simply claim Florida legal residency/domicile without ever having established that status in the past. And since the military member is a Florida legal resident/domiciliary, the spouse's status would have to match in order for P.L. 111-97 to be effective.

4. What the Law Could Require From Servicemembers. The States are still sorting out the implications of this law on their income tax and personal property tax systems. Since the law is effective immediately – and so close to tax season—the forms for 2009 are already prepared and will not likely address this legal residency issue. Further, if refunds are sought by military couples for State income tax withholdings or personal property taxes paid, we anticipate that there is a strong likelihood that the impacted States (*i.e.*, those losing significant tax revenue) will take a Missouri "Show me" approach and ask for proof of the

claimed legal residence/domicile.

a. It seems evident that the initial burden will be on the military member to establish the bona fides of their claimed legal residence/domicile, particularly if it is one of the State “tax havens.” Again, simply having FL or TX on an LES may not carry the day. The State may want to see evidence of the other indications of legal residency that show permanent residency and intent to return.

b. Assuming the military member can demonstrate sufficient evidence of their claim of legal residency/domicile, the burden then shifts to the spouse to demonstrate that they are entitled to share that same legal residence/domicile. Absence of physical presence along with their military spouse (trips to Disney World generally don’t count since they are not pursuant to military orders!) and minimal connections to the claimed State are likely to undermine the spouse’s argument that they share their military spouse’s State of legal residence/domicile.

5. Stay Tuned – More to Come on This Subject! Code 16 serves as the Navy Representative to the Armed Forces Tax Council (AFTC). The AFTC is working very closely with the State tax authorities through the Federation of Tax Administrators to identify the potential issues and seek some standard practices and procedures that would apply to most, if not all, States impacted by this new law. We will send out additional information when we have it.

a. **LA Practice Pointers.** The following are some key discussion points for LA practitioners in dealing with client questions on this law until we have further information:

i. This law does not create the right to “pick,” “choose,” or “claim” just any State of legal residence/domicile for military spouses. The spouse may only regain the right to claim the same State of legal residence/domicile of their military spouse IF they had once established such residency.

ii. Claims of changed residency are likely to be carefully scrutinized by State tax authorities, not just for spouses, but for the military member, since that is the basis for any spousal claim. If the military member has not maintained sufficient ties to the claimed State of legal residence/domicile, there may well be unintended consequences lurking in the weeds. (i.e., upon scrutiny it could be determined that the military member has been claiming the wrong state as his or her tax domicile).

iii. Claims of changed residency that have no basis in fact may well be viewed as fraudulent by State taxing authorities and subject the military family to significant additional taxes and penalties.

iv. Clients should be urged to tread carefully and avoid the expected onslaught of “tax counselors” who will help them facilitate refunds. Working with such folks is only likely to draw more scrutiny from the State authorities.



6. **Points of Contact.** For questions or comments about this LAPA, or if you have information you would like us to make available to your LA colleagues, please contact the Code 16 team. Our contact information is in the sidebar.

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