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Working Draft TIR 09-23: Effect of the Military Spouses Residency Relief Act

Attached for public and practitioner comment is draft Technical Information Release, Effect of the Military Spouses Residency Relief Act. Effective for taxable years that begin on or after January 1, 2009, the Military Spouses Residency Relief Act ("MSRRA") amends the Servicemembers Civil Relief Act ("SCRA") to provide rules for the determination of the residence or domicile for state tax purposes of a spouse of a servicemember. This Technical Information Release explains the effect of the MSRRA on the Massachusetts personal income tax for certain military spouses. Part V of the TIR explains how a qualified non-resident military spouse may file for a refund of tax withheld in 2009. Part VI of the TIR explains how such a spouse claims exemption from withholding for 2010 and subsequent years.

Please email any comments to rulesandregs@dor.state.ma.us by February 26, 2010.

WORKING DRAFT FOR PRACTITIONER COMMENT 2/12/10

Personal Income Tax Technical Information Release 09-23

Effect of the Military Spouses Residency Relief Act

The Military Spouses Residency Relief Act (P.L. 111-97 or "MSRRA") was enacted on November 11, 2009. Effective for taxable years that begin on or after January 1, 2009, the MSRRA amends the Servicemembers Civil Relief Act ("SCRA") to provide rules for the determination of the residence or domicile for state tax purposes of a spouse of a servicemember. This Technical Information Release ("TIR") explains the effect of the MSRRA on the Massachusetts personal income tax for certain military spouses. Part V of the TIR explains how a qualified non-resident military spouse may file for a refund of tax withheld in 2009. Part VI of the TIR explains how such a spouse claims exemption from withholding for 2010 and subsequent years.

I. Background: Residence of a Servicemember for Tax Purposes

The Servicemembers Civil Relief Act ("SCRA") governs the determination of a servicemember's residence or domicile for state tax purposes.^[1] The SCRA provides:

§ 571 Residence for tax purposes

- (a) Residence or domicile. (1) A servicemember shall neither lose nor acquire a residence or domicile for purposes of taxation with respect to the . . . income of the servicemember by reason of being absent or present in any tax jurisdiction of the United States solely in compliance with military orders.
- (b) Military service compensation. Compensation of a servicemember for military service shall not be deemed to be income for services performed or from sources within a tax jurisdiction of the United States if the servicemember is not a resident or domiciliary of the jurisdiction in which the servicemember is serving in compliance with military orders.

The purpose of the SCRA is to protect military service personnel from the risk of double taxation occasioned by their temporary duty pursuant to military orders in a state other than that of the state of domicile.^[2] The first subsection of the SCRA asserts that a servicemember's domicile remains the same as before the service period, despite long absences from the state of domicile and residence in other jurisdictions. No change is effected until the individual establishes a new place of residence, with the intention to make it the new permanent home and not to return to the former place of domicile.

The second subsection of the SCRA generally asserts that a servicemember's income is deemed earned in the state of domicile, even though the servicemember is performing duty in another state. Section 5A(c) of chapter 62 governs

the taxation of income earned by non-resident members of the military:

In applying this section [5A], the compensation paid by the United States to its uniformed military personnel assigned to duty at military posts, bases or stations within the commonwealth for services rendered by said personnel while on active duty shall be deemed to be from sources other than sources within the commonwealth.

Non-resident Servicemember Stationed in Massachusetts. A servicemember domiciled outside of Massachusetts at the date of entry into the service does not become subject to the Massachusetts income tax while residing in Massachusetts on military orders with no intention to make Massachusetts his or her permanent home. A non-resident servicemember, however, is subject to tax on Massachusetts source income earned other than from military sources.

Resident Servicemember. A servicemember remains subject to the Massachusetts personal income tax if his or her domicile was Massachusetts at the time of entering the service unless a new domicile is established while in the service. This applies even though the servicemember may be stationed outside of Massachusetts. If the servicemember's gross income is more than \$8,000, he or she is required to file a personal income tax return as a Massachusetts resident.

II. Amendment to SCRA: Residence of a Spouse of a Servicemember for Tax Purposes

Effective for taxable years that begin on or after January 1, 2009, the MSRRA amends the SCRA to provide rules for the determination of the residence or domicile for state tax purposes of a spouse of a servicemember:

§ 571 Residence for tax purposes

(a) Residence or domicile. (2) Spouses. A spouse of a servicemember shall neither lose nor acquire a residence or domicile for purposes of taxation with respect to the . . . income of the spouse 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, as the case may be, is the same for the servicemember and the spouse.

(c) Income of a military spouse. Income for services performed by the spouse of a servicemember shall not be deemed to be income for services performed or from sources within a tax jurisdiction of the United States if the spouse is not a resident or domiciliary of the jurisdiction in which the income is earned because the spouse is in the jurisdiction solely to be with the servicemember serving in compliance with military orders.

III. Domicile

For Massachusetts income tax purposes, the determination of an individual's status as a resident or non-resident is essential. Under G.L. c. 62, § 2, Massachusetts residents are taxed, with certain limitations, on all of their income from whatever sources derived. In contrast, Massachusetts taxes non-residents only on income derived from or connected to Massachusetts sources. See G.L. c. 62, § 5A.[\[3\]](#)

Resident. Under G.L. c. 62, § 1(f), the term "resident" means

(1) any natural person domiciled in the commonwealth, or (2) any natural person who is not domiciled in the commonwealth but who maintains a permanent place of abode in the commonwealth and spends in the aggregate more than one hundred and eighty-three days of the taxable year in the commonwealth, including days spent partially in and partially out of the commonwealth. For purposes of clause (2), a day spent in the commonwealth while on active duty in the armed forces of the United States shall not be counted as a day in the commonwealth.

Non-resident. Section 1(f) provides that the word "non-resident" means "any natural person who is not a resident or inhabitant."

Domicile. Although a person may have residences in more than one state, a person can have only one domicile for tax purposes. Domicile is defined as "the place of actual residence with intention to remain permanently or for an indefinite time and without any certain purpose to return to a former place of abode." *Commonwealth v. Davis*, 284 Mass. 41 (1933).

Massachusetts follows the common law rule that a person is considered to have changed his or her domicile by satisfying two elements: the establishment of physical residence in a different state and the intent to remain at the new residence permanently or indefinitely. *McMahon v. McMahon*, 31 Mass. App. Ct. 504 (1991).

Once a party has established a domicile, the burden of proving a change is upon the party seeking to establish the change. *Horvitz v. Commissioner of Revenue*, 51 Mass. App. Ct. 386 (2001).

IV. Effect of MSRRA on the Taxation of Certain Military Spouses

Under prior law, wage income earned in Massachusetts by a non-resident spouse of a servicemember was Massachusetts source income and, as such, was subject to Massachusetts withholding and the Massachusetts personal income tax.

Non-resident Spouse of Non-resident Servicemember. Under the MSRRA, a spouse of a servicemember may be exempt from Massachusetts personal income tax on “income from services performed in Massachusetts by the spouse” if all the following are applicable:

- (1) the servicemember must have declared “legal residence for purposes of withholding state income taxes from military pay” in a state other than Massachusetts;
- (2) the servicemember is present in or near Massachusetts in compliance with military orders;
- (3) the spouse is in Massachusetts solely to be with the servicemember;^[4] and
- (4) the spouse is domiciled in the same state as the servicemember.

For purposes of the 183 day rule in determining whether a servicemember or the spouse of a servicemember is a Massachusetts resident, a day spent in Massachusetts while on active duty in the armed forces of the United States is not counted as a day in the commonwealth. Thus, a servicemember or his or her qualifying spouse are not taxable as Massachusetts residents under the 183 day rule even though they have spent more than 183 active-duty days in Massachusetts. However, in a given year, for all periods spent in Massachusetts that are not active-duty days, once the number of days spent in Massachusetts exceeds 183 days, the individuals are taxable as Massachusetts residents.

If the servicemember and spouse are not subject to tax in Massachusetts, they are nevertheless subject to tax in their state of domicile, to the extent required by the law of the state of domicile.

Income from Services Performed in Massachusetts by the Non-Resident Spouse. The MSRRA applies to wages and other “income from services performed by the spouse of a servicemember.”

Business Income. A spouse’s income from self-employment may or may not qualify for the exemption. For example, if the spouse’s business does not employ others, and does not employ significant capital, then the predominant source of the business’ income is from the spouse’s performance of services and would qualify for the exemption. However, if the spouse’s business employs others who perform services, then the predominant source of the business’ income is not from the spouse’s performance of services and would not qualify for the exemption.

The MSRRA does not apply to other types of income that are not related to services performed. Items of gross income received by a qualifying non-resident military spouse that are derived from or effectively connected with the participation in any lottery or wagering transaction in Massachusetts, and the ownership of any interest in real or tangible personal property located in Massachusetts remain subject to taxation.

The MSRRA does not exempt non-military income earned in Massachusetts by a servicemember domiciled in a state other than Massachusetts.

Non-Massachusetts Domicile. The SCRA does not allow a servicemember simply to choose a state of domicile. In order to change his or her state of domicile, a servicemember must meet certain rules. He or she must have (or have had) a physical presence in the state as well as intent to one day make it his or her permanent home. That intent is borne out by facts and circumstances such as owning property, registering to vote, titling and registering automobiles, or preparing a will in the state.

The spouse of a servicemember must be able to establish that he or she was domiciled in another state (the same domicile as the servicemember) before moving into Massachusetts and that he or she maintained the domicile in that other state.

Massachusetts Domicile. A Massachusetts resident (who has not established residency in another state) and who is residing outside of Massachusetts solely to be with his or her servicemember spouse in compliance with military orders, and who earns income in that other state is subject to Massachusetts income tax on the income earned in that other state.

V. Refund of 2009 Wage Withholding and Estimated Taxes.

For taxable year 2009, a servicemember's spouse who had Massachusetts personal income tax withheld and who qualifies for exemption from Massachusetts tax under the MSRRA must file a Massachusetts non-resident income tax return, Form 1NR/PY, to claim a refund. For this purpose, the Form 1 NR/PY return must be paper filed; no efile returns are allowed. The qualifying spouse must write "MSRRA," across the top of the Form 1NR/PY and attach copies of the following:

1. Military Spouse ID card.
2. Department of Defense Form 2058, State of Legal Residence Certificate – "legal residence for purposes of withholding state income taxes from military pay;"
3. LES, Leave and Earnings Statement of servicemember; and
4. Servicemember's current military orders assigning such servicemember to a post of duty in Massachusetts (or an adjoining state).

The qualifying servicemember's spouse must pay tax to the state of domicile for 2009, to the extent required by the state of domicile.

Earned Income Credit Not Allowed. A non-resident spouse who qualifies for exemption from Massachusetts tax under the MSRRA does not qualify for the Massachusetts earned income credit applicable to non-residents. In order to claim the earned income credit, a non-resident taxpayer must have "earned income . . . from Massachusetts sources." [5] However, under the MSRRA, "income for services performed by the spouse of a servicemember shall not be deemed to be income for services performed or from sources within [Massachusetts]. . . ." [6]

How to complete the Form 1 NR/PY for tax year 2009 to receive a refund of withholding. The spouse must include the exempt wages that were subject to withholding on line 5 of Form 1 NR/PY, making a subtraction of such wages on Schedule Y, line 4.

Example 1. Facts: Carol's spouse, Robert, is a servicemember on active duty whose military orders assign him to a military base in Massachusetts. The domicile of both Carol and Robert is Georgia. For the year 2009, Robert has military income that is subject to tax in Georgia, and Carol has wages from employment in a store located in Massachusetts. Carol and Robert have no other income subject to tax. Carol's employer withheld Massachusetts personal income tax from her wages and issued a W-2 for 2009 showing the total Massachusetts tax withheld.

As a qualifying military spouse, Carol files a paper 2009 Form 1NR/PY and writes across the top "MSRRA."

- Enter on line 3 of Form 1NR/PY Carol's total income from the federal return (and, for a joint return, Robert's military wages).
- Enter Carol's W-2 wages on line 5 of Form 1NR/PY.
- Line 14 of Form 1NR/PY, Nonresident deduction and exemption ratio:
 - Enter zero on lines 14(a) – 14 (d)
 - Enter on line 14(e) Carol's W-2 wages (and, for a joint return, Robert's military wages)
 - Enter the amount from line 14(e) on line 14(f)
 - The ratio on line 14(g) will be zero (0.00)
- To deduct Carol's W-2 wages from "Massachusetts source income," enter Carol's W-2 wages on Schedule Y lines 4 and 16, and also on Form 1NR/PY lines 19 & 20.
- No other deductions (except Schedule Y, line 4) need to be entered.
- Enter the amount of Massachusetts withholding from Carol's W-2 wages on Form 1NR/PY lines 41 & 48 and also, as the refund amount, on lines 49 & 51.
- NOTE: A Massachusetts earned income credit is not allowable because Carol has no earned income from Massachusetts sources. Under the MSRRA, Carol's wages are deemed to be earned in Georgia. (For a joint return, under the SCRA, Robert's military wages are deemed to be earned in Georgia.)

Example 2. The facts are the same as example 1 for Carol and Robert, except Carol also has lottery winnings. Carol has Massachusetts W-2 wages of \$10,000 (exempt from Massachusetts tax under the MSRRA) and Massachusetts lottery winnings of \$15,000 (not exempt from Massachusetts tax under the MSRRA), and Robert has military wages of \$30,000 (exempt from Massachusetts tax under the SCRA).

As joint filers, Carol and Robert file a 2009 Form 1NR/PY (paper) and write across the top "MSRRA."

- Enter on line 3 of Form 1NR/PY Carol and Robert's total federal income of \$55,000.
- Enter on line 5 of Form 1NR/PY Carol's W-2 wages of \$10,000
- Enter on line 10(b) of Form 1NR/PY Carol's Massachusetts lottery winnings of \$15,000.
- Enter on line 12 of Form 1NR/PY \$25,000
- Line 14 of Form 1NR/PY, Nonresident deduction and exemption ratio: Enter on lines 14(a) – 14 (d) any Massachusetts income taxable to Massachusetts (exclude Carol's W-2 wages). Enter on line 14(e) Carol's W-2 wages and Robert's military wages.

Line 14(a)	15,000 (include only lottery winnings)
Line 14(d)	15,000
Line 14(e)	40,000 (30,000 plus 10,000)
Line 14(f)	55,000
Line 14(g) = divide 14(d) by 14(f)	.2727

- To deduct Carol's W-2 wages from "Massachusetts source income," enter Carol's W-2 wages on Schedule Y lines 4 and 16, and also include this amount on Form 1NR/PY lines 19 & 20.
- Enter all applicable deductions and exemptions on the appropriate lines
(The FICA deduction for Carol is not allowed for income excluded on Schedule Y)
- Continue to complete return based on 1NR/PY instructions
- NOTE: A Massachusetts earned income credit is not allowable because Carol has no earned income from Massachusetts sources. Under the MSRRA, Carol's wages are deemed to be earned in Georgia. Carol's winnings from the Massachusetts lottery do not qualify for the computation of the earned income credit because winnings are not "earned income" from Massachusetts sources. (For a joint return, under the SCRA, Robert's military wages are deemed to be earned in Georgia.)

VI. Wage Withholding.

For taxable years beginning with 2010, a non-resident servicemember's qualifying spouse whose wages are exempt from Massachusetts personal income tax under the MSRRA may claim an exemption from Massachusetts withholding tax. A military spouse who qualifies for Massachusetts wage exemption under the MSRRA must complete a Form M-4-MS, Annual Withholding Tax Exemption Certificate for Military Spouse, and provide required documentation.

The Form M-4-MS must be validated on an annual basis. The military spouse must show continued eligibility for the exemption. Scenarios that will cause the spouse to no longer be eligible include:

1. Servicemember leaves the service;
2. Divorce;
3. Voluntary physical separation due to duty changes – the servicemember's orders move him or her to a location outside Massachusetts where the spouse is allowed to join him or her but chooses not to; or
4. Spouse commits an action that clearly establishes Massachusetts as his or her state of domicile.

Employers. Chapter 62B requires every employer making payment to employees of wages subject to Massachusetts income tax under G.L. c. 62 to deduct and withhold taxes upon such wages. An employer is liable for failing to withhold the proper Massachusetts tax on a military spouse unless the employer has a properly completed Massachusetts Form M-4-MS from that employee.

Employers should request evidence that the military spouse is indeed a domiciliary of a state other than Massachusetts. Employers may also want to inquire with the military spouse's state of domicile as to whether the Massachusetts employer is required to withhold income tax for that state.

WORKING DRAFT FOR PRACTITIONER COMMENT 2/12/10

[1] The term "servicemember" means a member of the uniformed services, as that term is defined in section 101(a) (5) of title 10, United States Code. See 50 U.S.C.A. app. § 511(1).

[2] See *California v. Buzard*, 382 U.S. 386 (1966), *Carr v. Dept. of Revenue*, 2005 Or. Tax LEXIS 223 (Or. Tax

2005), and *Wolff v. Baldwin*, 9 NJ Tax 11 (NJ Tax Ct 1986).

[3] In relevant part, § 5A(a) provides:

. . . The Massachusetts gross income shall be determined solely with respect to items of gross income from sources within the commonwealth of [a non-resident] . . . Items of gross income from sources within the commonwealth are items of gross income derived from or effectively connected with: (1) any trade or business, including any employment carried on by the taxpayer in the commonwealth, whether or not the non-resident is actively engaged in a trade or business or employment in the commonwealth in the year in which the income is received; (2) the participation in any lottery or wagering transaction within the commonwealth; and (3) the ownership of any interest in real or tangible personal property located in the commonwealth. . . .

For more information on Massachusetts source income, see the Department's regulation at 830 CMR 62.5A.1, Non-Resident Income Tax.

[4] We view the scope of MSRRA to include the situation where the servicemember and the military spouse live near to the Massachusetts border but in another state, and the military spouse works in Massachusetts.

[5] See G.L. c. 62, § 6(h).

[6] In the case of a joint return, the servicemember and qualifying spouse would qualify for the earned income credit applicable to non-residents to the extent the servicemember has Massachusetts wages other than from military sources.

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