

INFORMATION BULLETIN #27

INCOME TAX

JANUARY 2010

(Replaces Information Bulletin # 27, dated May 2008)

DISCLAIMER: Information bulletins are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules, and court decisions. Any information that is inconsistent with the law, regulations, or court decisions is not binding on either the Department or the taxpayer. Therefore, information provided in this bulletin should serve only as a foundation for further investigation and study of the current law and procedures related to its subject matter.

SUBJECT: Indiana Adjusted Gross Income Tax Applicable to Military Personnel and Spouses

REFERENCE: IC 6-3-1-2.5; IC 6-3-1-2.7; IC 6-3-1-3.5; IC 6-3-1-34; IC 6-3-2-4

EFFECTIVE DATES: The increased military service pay deduction and the deduction for certain military income received by a member of the reserves or National Guard are effective for compensation received on or after Jan. 1, 2008.

The allocation of income for earned income received by spouses of military personnel is effective for compensation received on or after Jan. 1, 2009.

INTRODUCTION

Regular Members of the Armed Forces

Indiana adjusted gross income tax applies to members of the armed forces of the United States, which include the Army, Air Force, Marines, Navy, Coast Guard, Air National

Guard, National Guard, and Navy Merchant Marines. Indiana resident regular members of the armed forces are taxable on all income, regardless of source. Nonresident regular members of the armed forces are taxable on all nonmilitary income received from Indiana sources.

Reserve Components and National Guard

A member of a reserve component of the armed forces or a member of the National Guard is allowed a deduction from adjusted gross income for service as a result of service on involuntary orders or when the person is deployed or mobilized for full-time service, or during the period for which the member's National Guard unit is federalized.

Spouses of Military Personnel

Indiana adjusted gross income tax applies to all the income of a domiciled spouse of an armed forces member, regardless of source. However, pursuant to the Military Spouses Residency Relief Act (Public Law No. 111-97), Indiana adjusted gross income tax does not apply to the earned income of a non-domiciled spouse of an armed forces member.

I. RESIDENCY

Military personnel who enter the armed forces as Indiana residents remain legal residents of Indiana regardless of duty station until official action is taken to change their legal residence. This can be accomplished by filing a State of Legal Residence Certificate, Form DD 2058, with the military personnel office.

The spouse of an armed forces member who moves to Indiana, establishes a new residence, and lives here typically becomes a domiciliary of Indiana. However, pursuant to the Act, the spouse of an armed forces member may choose to keep a previous domicile under defined circumstances.

The spouse of an armed forces member is exempt from Indiana income taxation on Indiana-source earned income when:

- The spouse currently is domiciled in a state other than Indiana;
- The spouse resides in Indiana solely in order to live with the armed forces member;
- The armed forces member is present in Indiana in compliance with military orders; and
- The spouse and the armed forces member both are able to claim the same domicile.

II. FILING REQUIREMENTS

Resident military personnel are required to file an Indiana income tax return if their gross income exceeds their exemptions. Income from all sources, both military and nonmilitary

(excluding military combat zone compensation), should be reported on the Indiana resident return, Form IT-40.

Nonresident military personnel are required to file an Indiana income tax return if they receive any income from an Indiana source. Military earnings for active duty are not considered to be from an Indiana source; however, other compensation for part-time employment would be attributable to Indiana. Nonresident servicemembers should file an Indiana part-year or nonresident return, Form IT-40PNR, to report their other compensation.

Military personnel may be subject to tax by both their state of legal residence and the state in which they are stationed if they have nonmilitary earnings. Persons with income subject to tax by two states are allowed a credit in one state for tax paid to the other state. Information Bulletin #28 provides additional information for taxpayers with income subject to tax by two states.

Beginning with the 2009 tax year, an eligible spouse of a non-Indiana-domiciled armed forces member should file an Indiana part-year or nonresident return, Form IT-40PNR, to claim a deduction of all Indiana-source earned income. Schedule IN-2058SP and the armed forces member's W-2 must be enclosed with the filing.

III. DEDUCTIONS AVAILABLE TO INDIANA RESIDENTS FOR MILITARY SERVICE

A. Military Service Deduction

Military personnel on active duty or in the active reserves may deduct up to \$5,000 of their military pay if it was not already excluded or deducted from their adjusted gross income. If they earned less than \$5,000 military pay, they may deduct only the amount of military pay they earned. If the taxpayer and spouse are both in the military, they each may claim the deduction.

Claim the deduction on IT-40 Schedule 2, line 7 (or Form IT-40PNR Schedule C, line 7).

Example: Jim received \$3,000 active duty pay and \$10,000 combat zone pay during the year. He is eligible to claim a \$3,000 military service deduction based on his active duty pay. He may claim the deduction on IT-40 Schedule 2, line 7 (or on Form IT-40PNR Schedule C, line 7). Jim will not deduct any of his combat zone pay because it is not reported as taxable income on either his federal or state income tax returns—it is already exempt from tax.

Example: Mary earned \$6,000 from the National Guard during the year *before* her unit was federalized. She may claim a \$5,000 regular military service deduction based on the income earned before her unit was federalized. She may claim the deduction on IT-40 Schedule 2, line 7 (or on Form IT-40PNR Schedule C, line 7).

Military retirement pay received by an Indiana resident is taxable in the same manner that it is for federal tax purposes. An individual, or an individual's surviving spouse, is allowed an adjustment of up to \$5,000 for retirement pay or survivor's benefits received as a result of the individual's active or reserve service in the armed forces, provided that the individual, or the individual's surviving spouse, is at least 60 years of age. The individual need not have been an Indiana resident during active military service to qualify for this adjustment.

Example: Sam, who is 63, received \$7,500 military retirement pay during the year. He is eligible to claim the maximum \$5,000 military service deduction. He may claim the deduction on IT-40 Schedule 2, line 7 (or on Form IT-40PNR Schedule C, line 7).

Military withholding statements or retirement survivor's benefits statements must be attached to the tax return when these deductions are claimed.

Note: If you received a combination of military pay, retirement pay, and/or military survivor's benefits during the tax year, the total military service deduction reported on line 7 of Schedule 2 or Schedule C cannot be more than \$5,000 per qualifying person.

B. Nonresident Military Spouse Earned Income Deduction

The non-domiciliary spouse of an armed forces member may, under defined circumstances, claim the Indiana Nonresident Military Spouse Earned Income Deduction equal to the amount of his/her Indiana earned income. For purposes of the deduction, "earned income" is defined in uniformity with the IRC Section 62 definition of earned income, which includes "wages, salaries, tips, and other employee compensation, plus the amount of taxpayer's net earnings from self-employment income (federal Schedule C income)." Claim the deduction on IT-40PNR, Schedule C, line 11.

Example: Jack is a domiciliary of Texas. During 2009, he moved to Indiana to be with his wife, Jill. Jill is stationed in Indiana in compliance with her military orders, but she, like Jack, remains a domiciliary of Texas. Jack owns his own business, which he operates in Indiana while he is residing here. Jack is entitled to claim a Nonresident Military Spouse Earned Income Deduction equal to the amount of his Indiana earned income. He may claim the deduction on Form IT-40PNR, Schedule C, line 11.

Example: Jenny is a domiciliary of Rhode Island. During 2009, she moved to Indiana to be with her husband, Paul. Paul is stationed in Indiana in compliance with his military orders, but before he enlisted he was, and remains, a domiciliary of Iowa. Jenny is not entitled to claim a Nonresident Military Spouse Earned Income Deduction because she and her spouse are not domiciliaries of the same state. Jenny's earned income in Indiana will be subject to Indiana adjusted gross income tax on Form IT-40PNR.

IV. COUNTY INCOME TAXES

A majority of Indiana counties have adopted one (or a combination) of the three local option income taxes. They include the (1) County Adjusted Gross Income Tax (CAGIT); (2) County Option Income Tax (COIT); and (3) County Economic Development Income Tax (CEDIT). The tax is imposed on residents of adopting counties and residents of non-adopting counties who work in an adopting county. A list of the adopting counties and their rates is provided in the individual income tax booklets: IT-40 and IT-40PNR.

Resident military personnel are subject to a local option income tax if, on January 1 of the tax year, their county of residence is a county that has adopted a local option income tax. However, a resident military person who maintains a household outside the state of Indiana is not subject to a county tax.

The income of a spouse of an armed forces member is not subject to county tax, provided that the non-domiciled spouse qualifies for the Nonresident Military Spouse Earned Income Deduction. If the spouse does not qualify for the deduction, his or her Indiana earned income may be subject to county tax if, on January 1 of the tax year, the spouse's residence or principal place of work activity was in an Indiana adopting county.

V. ESTIMATED TAX

A military person who expects to owe \$1,000 or more in state and/or county income tax may be required to make estimated installment payments. Generally, the military will withhold Indiana state income tax from military earnings of resident military personnel in an amount sufficient to avoid estimated tax payments on military earnings. However, county tax is not withheld. Other types of income not subject to withholding of tax could result in an amount due of \$1,000 or more of state and/or county tax due for the year.

Taxpayers may be subject to a penalty for underpayment of estimated tax if they do not make the required estimated payments. To establish an estimated account, the first payment must be made. A coupon booklet will be issued for the remaining installment periods.

For further information concerning estimated tax, see Income Tax Information Bulletin #3.

VI. DUE DATES AND EXTENSION OF TIME FOR FILING

Indiana individual income tax returns are due on or before April 15 of the year following the tax year. Military personnel on active duty outside of the United States and Puerto Rico will be allowed an automatic 60-day extension. A statement must be attached to the return verifying that the taxpayer was outside the United States or Puerto Rico on April 15.

Military personnel serving in a combat zone have an automatic extension of 180 days after they leave the combat zone. If they are hospitalized outside the United States as a result of such service, the 180-day extension period begins upon release from the hospital. The spouse of such a servicemember must use the same method of filing for both federal and Indiana income tax returns. If filing under this extension, write "Combat Zone" across the top of the form before submitting the form to the Department for processing.

A handwritten signature in black ink that reads "John Eckart". The signature is written in a cursive style with a large, looping initial "J".

John Eckart
Commissioner