WHAT IT MEANS TO BE A RESIDENT FOR TAX PURPOSES
AND APPLYING RESIDENCY TO MILITARY SPOUSE RESIDENCY RELIEF ACT

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At the Tax Center, we find clients are often uncertain of their residency. While residency is fairly clear for Servicemembers, determining domicile for non-military spouses can be tricky and may result in different tax liability.

The IRS considers the state listed on the Servicemember's W-2 as the home of record, also known as the legal residence or domicile. The Servicemember pays taxes to that state if military income is not exempt. Servicemembers may either keep their original home or record or change it after establishing ties to a new state they intent to make a permanent home. Servicemembers have the responsibility to accurately report their home of record. While no magic combination of factors exists, holding a driver's license, voter registration, car registration, and owning property in the state are all evidence of domicile. Because state requirements for domicile vary, it is always safest to research the state laws where you want to claim domicile. Selecting a state where you have never lived purely to avoid income tax is inappropriate and may subject your tax return to challenge and an audit.

Non-military spouses do not have the luxury of a simple W-2 indicating their home of record. All the above factors must be considered regardless of the state appearing on any W-2. Until recently, the spouse had to file a tax return in the state where he or she earned income, regardless of legal residence. However, this is not always the case now.

Implications of MSRRA:

In 2009, a new federal statute called the Military Spouse Residency Relief Act (MSRRA), allowed spouses of Servicemembers, under limited circumstances, to maintain their home of record, despite moving due to PCS orders. This changed tax rules for military families.

MSRRA applies if the spouse meets all of the following three conditions: (1) the Servicemember is in the state due to military orders; (2) the spouse is there solely to be with the Servicemember; and (3) the spouse has the *same* legal residence as the Servicemember. People commonly misunderstand the statute. If a spouse working in North Carolina does not have to file North Carolina taxes, this does not mean he or she is off the hook for taxes all together. Unless the home of record does not have state income tax, the spouse must file a return for his or her home state. Two states offer an exception to this rule: California and Connecticut do not require the spouse to file if the Servicemember is exempt. For everyone else, if the domicile state requires the spouse to file, the spouse should ask his or her employer to withhold taxes for the domicile state rather than North Carolina to avoid owing taxes at the end of the year. If the employer cannot withhold another state's taxes, the spouse should make estimated payments throughout the year to avoid possible penalties and fees.

Once the spouse makes the decision to file based on the statute, he or she should stay consistent, even if filing in that particular state is less advantageous the following year. Jumping back and forth between residencies may cause both states to audit the tax payer to establish residency and can result in owing taxes for previous years plus penalties and interest if taxes were misfiled.