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State Taxation and Tax Protection for Military Families

MILITARY SERVICE OFTEN REQUIRES people to work and live in a state other than their home state. As a result, service members often have tangled connections to multiple tax jurisdictions. Federal law is designed to protect the choice of domicile of active-duty military members and their spouses, but confusion over the law reigns, and, as a result, various states may pursue income tax deficiencies against service members. Although some states do not tax income at all,¹ other states (including California) treat military members as nonresidents for tax purposes if they are absent from the state, and therefore only tax active-duty military domiciliaries on income earned while they are permanently stationed in California.² If they are permanently assigned outside the state, they become nonresidents of California for income tax purposes and are not taxed on income earned while out of state.³ But other states do not confer this immunity from taxation. So, if a domiciliary from such a state is assigned to duty in California, it may trigger a taxable residency claim, and both states could assert income tax jurisdiction.

The Servicemembers Civil Relief Act (SCRA) protects service members from various civil legal processes that could adversely affect them while they are away from their homes serving the United States.⁴ The SCRA postpones or suspends various civil obligations pertaining to leases, credit card interest, mortgage foreclosures, judicial proceedings, and state income tax. Section 571 of the SCRA (residence for tax purposes) specifically protects service members from double state taxation of income and personal property. The provision prevents the loss or acquisition of a military member's domicile due to the presence or absence in a tax jurisdiction by reason of military orders.⁵ Previously, military spouses had never been granted the same protections, which complicated joint returns. However, the Married Spouses Residency Relief Act (MSRRA) of 2009 amended the SCRA and extended similar protection to certain military spouses.⁶

The SCRA provides:

A service member shall neither lose nor acquire a residence or domicile for purposes of taxation with respect to the person, personal property or income of the service member by reason of being absent or present in any tax jurisdiction of the United States in compliance with military orders....⁷

Compensation of a service member 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 service member is not a resident or domiciliary of the jurisdiction in which the service member is serving in compliance with military orders.⁸

Thus, a service member's military compensation is protected from double income taxation under the fiction that the income is earned only in the state of domicile regardless of where it is actually earned. The issue for both the service member and state taxing authority is

deciding which state is the domicile.

A state's power to tax, some states' special treatment for military income, and federal law preventing double state taxation all seem like simple concepts until one asks a military member, "Where are you from?" A Captain Jane Doe may answer that her "home of record" is San Diego, but she had been "residing" in Virginia during her tour at the Pentagon before her year of deployment to Afghanistan. She thinks her "legal residence" is Texas, because she owns a house in San Antonio and her military pay stub indicates Texas. She holds a Texas driver's license, but her new car is registered in Virginia. She most

States are within their authority to critically examine service members' claims of SCRA-protected out-of-state domicile.

recently voted absentee in Texas but then registered to vote in Virginia. She may add that her husband is from Michigan, but he spent the last year working in Virginia while she was deployed. They are moving to Fort Irwin, California, on permanent orders next month. She might believe she is a resident of California, because she was born in San Diego and lived there her entire life until she joined the Army. She is adamant that her "domicile" for the last year was Kabul, because she seeks the combat-zone tax exclusion.⁹

The Concept of Domicile

Service members, their family members, and tax administrators frequently confuse home of record, legal residence, and domicile. The key to determining which state, if any, can tax Captain Doe's or her husband's income requires a clear understanding of these terms, the most important of which is "domicile."

"Domicile" means a person's true, fixed, and permanent home, to which that person intends to return and remain even though currently residing elsewhere.¹⁰ It differs from residence, which is the place one is actually living for an undetermined period and is not necessarily combined with the intent to stay permanently.¹¹ As noted, the SCRA treats "residence" and "domicile" interchangeably due to the fact that some states equate the two or, in the case of California, assert tax jurisdiction over statutory residents who may not be domiciled in California.¹² The issue of domicile is largely determined based on a person's intent. If a person has physically lived in a place, the issue is always whether the person intends to remain or return to that place.

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The subjectivity of intent often requires courts to look at objective factors and draw conclusions that may conflict with what a service member believes to be his or her domicile.

Courts consider indicia of domicile when analyzing whether a person intends to permanently reside somewhere. The applicable factors include physical presence, payment of taxes, ownership of real property, voter registration, vehicle registration, driver's license, professional licenses, declarations of residence in legal documents, and declaration of domicile in affidavits or litigation.¹³ Military people move a lot. They often establish indicia of domicile in multiple places. Captain Doe likely resided in Afghanistan during her physical deployment, but probably does not intend to return permanently. Sorting out domicile requires a close look at the facts and knowledge of the various terms. One of the most misunderstood terms is the "home of record."

"Home of record" refers to the place from which a person was appointed or enlisted into the military. It is used to determine a person's maximum travel and transportation entitlement upon leaving military service. It may or may not be the same as one's domicile or residence. Captain Doe claims San Diego as her home of record. This only means that she entered the service in San Diego, and if she leaves the service at Fort Bragg, North Carolina, her transportation and travel entitlement will be the value it takes to move her and her goods from Fort Bragg back to San Diego. However, if she entered military service from college at the University of North Carolina, the military would only pay the value of moving her and her goods from Fort Bragg, North Carolina, to Chapel Hill, North Carolina. When service members speak of their "home of record," they may mean their hometown, their home state, or perhaps where they entered service, but one should be very cautious about equating it with domicile.

"Legal residence" is another term sometimes equated with domicile; the terms are often used interchangeably.¹⁴ Captain Doe resided in Virginia while working at the Pentagon and she "resided" in Afghanistan while deployed there. It would seem she also resided in Texas at some point in the past. As long as she was or is physically present in a place, she is residing there. But domicile, its protectable status under the SCRA, and the power to tax domiciliaries turn on intent to remain or return. Captain Doe called Texas her "legal residence." It appears she believes Texas is her domicile, because she owns a house, has a driver's license, and votes in Texas. She also lists Texas as her withholding state on her military pay statement. Captain Doe may also be claiming Texas as her legal residence because Texas does not tax

income. Should Virginia or California attempt to tax her income, she will have the burden of establishing her intent to return to Texas through strong indicia of domicile.

One of the most common issues pitting military members and state tax authorities against each other is the double nontaxation issue. Service members often legitimately assert a domicile in a state that does not have an income tax.¹⁵ Too often, however, the concept is misunderstood and confused with home of record, or the belief that the member may simply assert a given state as the member's domicile without establishing or maintaining indicia of domicile. The Oregon Tax Court faced this situation in *Carr v. Department of Revenue*.¹⁶

Navy Senior Chief Carr entered active duty in 1980 in Las Vegas, Nevada, and served for 25 years, ultimately retiring in Oregon.¹⁷ He served in Portland, Oregon, from 1993 to 1996 before he transferred to California, where he remained until 1999.¹⁸ He was reassigned to Oregon in 1999, where he remained until he retired in 2005. Oregon assessed personal income tax for the 2001, 2002, and 2003 tax years. The issue was whether Chief Carr sufficiently established domicile in Oregon subjecting him to taxation despite his being there as an active-duty service person and claiming Nevada (a state without income tax) as his domicile. The court found that Chief Carr had established a new domicile in Oregon and upheld the tax assessment.

The SCRA, (as did its predecessor, the Soldiers and Sailors Civil Relief Act) provide that a member neither loses nor acquires tax domicile by being present in or absent from a state solely due to military orders. The court rightly observed that while the act of being posted to a state does not change domicile, a state can and often does look at other factors that might establish domicile, even unknowingly. In this case, Chief Carr bought a house in Oregon in 2001 and registered his vehicles in Oregon. He maintained no ties with Nevada other than some extended family living there. He did not own property in Nevada, hold a Nevada driver's license, register his vehicles, or vote in Nevada. Moreover, in a 1999 bankruptcy filing, he listed California as his domicile. Faced with almost no evidence of ties to Nevada or any other state, the court concluded that purchasing a home and registering vehicles in Oregon, though tenuous, was the strongest indicia of domicile to any state.

This case turned more on Chief Carr severing his ties with Nevada than on his affirmatively establishing domicile in Oregon. Chief Carr likely confused home of record and domicile. He enlisted in Nevada, and at the time it probably was his domicile. He likely

registered his car, held a driver's license, and voted in Nevada. His mistake was not maintaining those ties. The lesson from this case is that a bare assertion of domicile, without conduct to back it up, is not enough. In addition, if a service member allows his or her domicile to lapse, the SCRA will not act as a shield against his or her future actions in a new state that establish ties to that state. Had Chief Carr maintained strong ties with Nevada, buying a house and registering vehicles while residing in Oregon might arguably not have been sufficient to establish tax jurisdiction there.¹⁹ But in the absence of evidence connecting him to any other state, it was enough for the court to declare him an Oregon domiciliary.

In *Palandech v. Department of Revenue*,²⁰ the Oregon Tax Court again faced the issue of double nontaxation, but, although the ties to the non-income tax state were stronger, the court similarly concluded that Oregon had taxing jurisdiction over the service member. Palandech was a dentist with the Public Health Service (PHS), and he lived in Oregon, Washington, New Mexico, Arizona, and Oregon again throughout his career. He established and essentially severed ties with each state along the way. In his final assignment in Oregon, he claimed a Washington domicile, but Oregon disagreed and assessed personal income tax for years 2004, 2005, and 2006.

Palandech was born and raised in California. He completed dental school in Illinois and in 1980 established himself in Oregon. He bought a home, obtained a dental license and a driver's license, and practiced dentistry in Oregon. In 1984 he joined the PHS and remained in Oregon until he was assigned to Washington in 1989.²¹ Once in Washington, Palandech established ties there. He registered to vote, obtained a driver's license, registered his cars, and declared Washington his legal residence for state income tax withholding. He also sold his Oregon house and rented a house in Washington.²² He was reassigned to New Mexico in 1991 and then to Arizona in 1993, where he remained until 1998. During this time, he purchased unimproved land as an investment in Oregon with the possible intent to build a house. But he also bought a house in Arizona, and turned on utilities, telephone service, and enrolled his children in school. He also opened bank accounts in Arizona.²³ When Palandech was reassigned back to Oregon in 1998, he sold his Arizona house and bought a five-bedroom house in Salem, Oregon. The entire time, he maintained his Washington driver's license and voting registration.²⁴ The issue once again was to determine the true location of his domicile through examining overt indicia of domicile and inferring intent.

The court concluded that the case was a

“straightforward” residency case.²⁵ The court accepted the premise that Palandech’s initial Oregon domicile was protected by the SCRA. Thus, Palandech would neither lose Oregon domicile nor acquire Washington domicile simply by residing in Washington in accordance with military orders. But the court concluded that Palandech abandoned Oregon and intended to acquire Washington as his domicile after looking at several key factors such as selling his Oregon house, obtaining a Washington driver’s license, registering to vote, registering his autos, and declaring Washington as his domicile for income tax withholding.²⁶ Unfortunately for Palandech, the court performed the same analysis when he moved back to Oregon in 1998. The court cited the unimproved lot purchased in Salem with the intent to build, the house purchase, opening of bank accounts, registration of autos, Palandech’s active Oregon dental license, moonlighting as a dentist in Oregon while on active duty, and his family members living in Oregon as the basis for finding Oregon domicile.

Unlike *Carr*, in which no ties to Nevada remained and only tenuous ties to Oregon existed, the *Palandech* court was not so apologetic in finding Oregon domicile. Although Palandech kept his Washington driver’s license and voter registration—two strong indicia of domicile, the court saw this as a veneer. It believed that his other affirmative actions in Oregon reflected his true intent to remain in Oregon. In addition, the court noted that Palandech purchased the unimproved lot in Oregon, not Washington, and he registered his autos in Oregon, not Washington. Arguably the Washington ties could have led the court to find that the Washington domicile was not lost in moving to Oregon, but the court noted that when Palandech moved to Arizona, he closed his Washington bank accounts. The court simply did not believe that Palandech intended to return to Washington.

Carr and *Palandech* highlight several concepts about the SCRA. First, the SCRA is meant to protect a service member from double state income taxation. Military members often establish domiciles in states that do not have income tax,²⁷ creating a double nontaxation benefit. Second, as these cases show, the burden is on the service member to establish and maintain legitimate domicile through indicia of domicile or else be subject to challenge. It is not enough to simply declare a tax-favored jurisdiction, nor is it enough to make a half-hearted effort at maintaining the tax-favored domicile. Third, as the Oregon Department of Revenue has demonstrated, states are within their authority to critically examine service members’ claims of SCRA-protected out-of-state domicile and overt acts within their state.

The SCRA domicile issue historically applied just to the service member. However, with the passage of the MSRRA, states are faced with out-of-state domicile assertions from military spouses. Thus, the issue of domicile will become even more subject to debate as states also have to establish the ability to tax military spouses’ income.

Under the MSRRA and California law, “a nonmilitary spouse of a military service-member shall neither lose nor acquire a residence or domicile for tax purposes by being absent from or present in California to be with the servicemember serving in compliance with military orders if the servicemember and the spouse have the same domicile.”²⁸ While the law affords the same domicile protection (and pitfalls) as the SCRA, to qualify, California has three requirements: 1) the spouse must be present or absent in California to be with the service member spouse, 2) the service member must be in compliance with military orders, and 3) the service member and spouse must have the same domicile.²⁹ For example, while stationed in Texas, a service member who is a Texas domiciliary marries a civilian spouse who is also a Texas domiciliary. Next, the service member receives orders to move to California, and the spouse moves in order to be with him or her. The spouse could claim MSRRA protection and California would not tax the spouse’s income earned in California, because both had the same domicile of Texas and the spouse moved to California to be with a service-member spouse. However, as seen in *Carr* and *Palandech*, the burden of establishing and maintaining strong Texas indicia of domicile is on the member and his or her spouse. This outcome could change if the service member moved to California and then married a California domiciled spouse or married a Michigan domiciled spouse. In those cases, the “same domicile” prong would fail. It is important to remember that just like the service member, the spouse cannot simply choose a convenient domicile. The spouse is subject to the same domicile scrutiny as the service member when asserting a given jurisdiction.

Recall Captain Doe and her answer to, “Where are you from?” If she is on her way to California with her husband, how would one advise her regarding state income tax liability for 2012? The first step would be to determine her domicile. While she was born in California and entered the service there, she offers no further evidence that she maintained a California domicile once she left the state. Her strongest indicia of domicile comes from Texas, where she owns real property, holds a driver’s license, voted, and declared Texas as her state for income tax withholding. As noted, Texas is a common domicile among service members because of its tax-

favored status. But during her time in Virginia, Captain Jones registered a new car and registered to vote. She may have put herself at risk with Virginia, which could challenge her claim of Texas domicile. If Captain Doe hopes to rely on SRCA protecting her Texas domicile when she moves to California, she is best advised to register her car in Texas, reregister to vote in Texas, and take other steps to indicate her intent to return, if that is the case. Otherwise, she could also be at risk for a domicile challenge in California. As noted in *Palandech*, subsequent moves and subsequent actions can function to change domicile, even unwittingly.

Likewise, determining her husband’s domicile is the first step in determining his tax liability and whether he could claim protection under the MSRRA upon their move to California. His domicile is not clear from the facts. It could be Michigan, it could be Virginia, or it could be Texas. One should ask where and when they were married and what indicia of domicile he has with each state. To receive MSRRA protection from California taxation, he will have to travel to California to be with his military spouse pursuant to her military orders. Moreover, they both must arrive with the same domicile, whether Texas or Virginia. Unless those elements are met, he would not receive MSRRA protection.

Servicemembers have significant tax benefits,³⁰ but state income taxation based on domicile is often a confusing factual maze to navigate—especially with constant moves from one state taxing jurisdiction to another. The multiple moves and misunderstanding of terms and law can place tax authorities and service members at odds over the issue of state income taxation. Now more than ever, as states scramble to find income, service members and their spouses need to understand the basic rules for establishing and maintaining a legitimate domicile. Although the SCRA, and now the MSRRA protect service members and their spouses from gaining or losing domicile, tax authorities have shown they may be paying more attention to the rules than are the service members. Service members and their tax advisers would benefit greatly by fully understanding what it takes to establish, maintain, and defend a domicile under the SRCA and MSRRA. ■

¹ See http://www.taxadmin.org/fta/rate/mil_chart03.htm. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not have a broad-based state income tax. *Id.*

² STATE OF CALIFORNIA FRANCHISE TAX BOARD PUBLICATION 1032, TAX INFORMATION FOR MILITARY PERSONNEL (2011).

³ Orders for more than 179 days are considered permanent change of station (PCS) orders. Orders for 179 days or less are considered temporary duty orders (TDY). California residents out of the state on TDY

orders are still considered residents for income tax purposes.

⁴ The SCRA was originally called the Soldiers and Sailors Civil Relief Act of 1940, amended in 2003 and 2009 and codified at 50 U.S.C. app. §§501-596. Section 571 (tax residence) is the former §574 and remains substantially the same.

⁵ 50 U.S.C. app. §571; *See Dameron v. Brodhead*, 345, U.S. 322 (1953) (upholding the constitutionality of SSCRA §574, the forerunner state tax provision). This article focuses on income tax, not personal property, but note that intangible personal property includes bank accounts, stocks, etc., which could become relevant for income tax purposes.

⁶ The Married Spouses Residency Relief Act, Pub. L. No. 111-97 (2009) (adding provisions protecting spouses of military members losing or acquiring domicile by reason of being present in or absent from a tax jurisdiction solely to be with a service member in compliance with the service member's military orders).

⁷ 50 U.S.C. app. §571(a)(1).

⁸ 50 U.S.C. app. §571(b). Note that nonmilitary income is not protected and can be taxed by the state of domicile and the state in which the income is earned.

⁹ I.R.C. §112 (excluding from gross income compensation earned for active service in a combat zone). *See also* REV. & TAX CODE §17131 (2012) (adopting I.R.C. §112); Evan M. Stone, *Combat Zone Tax Exclusion*, CALIFORNIA TAX LAWYER, Winter 2012.

¹⁰ BLACK'S LAW DICTIONARY 559 (9th ed. rev. 2009) (defining domiciliary as a person who resides in a particular place with the intention of making it a principal place of abode); *See also* Mitchell v. United States, 88 U.S. 350, 352 (1874) (defining domicile as a residence at a particular place accompanied with a positive or presumptive proof of an intention to remain there for an unlimited time).

¹¹ BLACK'S LAW DICTIONARY 1423 (9th ed. rev. 2009) (defining residence as the place where one actually lives, as distinguished from domicile).

¹² REV. & TAX CODE §17016 (2012) (establishing a rebuttable presumption of residency for every individual who spends in aggregate more than nine months of the taxable year within California).

¹³ Other factors include expressed intent, residence of immediate family members, location of schools attended by children, leasehold interests, situs of personal property, location of bank and investment accounts, home of record, place of marriage, and spouse's domicile.

¹⁴ *See e.g.* DD Form 2058, State of Legal Residence Certificate (explaining that domicile and legal residence are essentially interchangeable). This form is filled out by service members and instructs the defense finance accounting office as to the state for which income taxes will be withheld from wages, if any.

¹⁵ *Supra* note 1.

¹⁶ Carr v. Department of Revenue, 2005 Ore. Tax LEXIS 223.

¹⁷ *Id.* at 1.

¹⁸ *Id.*

¹⁹ *See* Matter of Karsten, 924 P. 2d 1272 (Kan. App. 1996) (Purchasing a house or registering a motor vehicle in a host jurisdiction does not automatically change a service member's domicile unless the service member indicates intent to change domicile.).

²⁰ Palandech v. Department of Revenue, 2011, Ore. Tax. LEXIS 146.

²¹ *Id.* at 2.

²² *Id.* at 3.

²³ *Id.* at 5.

²⁴ *Id.*

²⁵ *Id.* at 7.

²⁶ *Id.* at 22. *See* White v. Department of Revenue 14, OTR 319, 321 (1998) (establishing a three-part test to

effect a change in domicile: 1) residence in another place, 2) intent to abandon old domicile, and 3) intent to acquire new domicile).

²⁷ *Supra* note 1.

²⁸ 50 U.S.C. app. §571(a)(2) and (c); STATE OF CALIFORNIA FRANCHISE TAX BOARD PUBLICATION 1032, TAX INFORMATION FOR MILITARY PERSONNEL (2011). Unlike the SCRA, which only protects military income of the service member from taxation, the MSRRA protects all income for services performed. *Id.*

²⁹ STATE OF CALIFORNIA FRANCHISE TAX BOARD PUBLICATION 1032, TAX INFORMATION FOR MILITARY PERSONNEL (2011). It should be noted that although the rules applying SCRA are set forth in REV. & TAX CODE §17140.5, the rules relating to MSRRA have not been codified in the REV. & TAX CODE. It would appear, therefore, that the Franchise Tax Board has adopted MSRRA as a matter of tax policy and affords its benefits to the spouses of service members.

³⁰ For example, I.R.C. §112 excludes compensation received for active service in a combat zone. Other combat-zone-related tax benefits include but are not limited to: I.R.C. §104(a)(4) (excluding combat-related disability payments), I.R.C. §134(b)(6) (excluding state payments due to service in a combat zone), I.R.C. §692(a) (tax forgiveness if a member dies in a combat zone), I.R.C. §2201 (reduced estate tax liability), I.R.C. §4253(d) (no excise tax on phone calls originating in a combat zone), and I.R.C. §7508(a) (180-day automatic extension of time to file and pay income tax). The I.R.C. provides many other noncombat-related tax benefits to service members, such as I.R.C. §217(g) (moving and storage), I.R.C. §134 (exclusion of qualified military benefits, e.g., BAH/BAS), I.R.C. §265(a) (tax-exempt income not subject to apportionment/allocation), and I.R.C. §121 (expanded time for gain exclusion on the sale of principal residence).

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