

## DEPARTMENT OF STATE REVENUE

**Information Bulletin #27**  
**Income Tax**  
**July 2020**  
**(Replaces Bulletin #27, dated November 2018)**  
**Effective Date: Upon Publication**

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

**REFERENCES:** [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](#); [IC 6-8.1-9-1](#); 50 U.S.C. § 4001; *Army Regulation 525-93* (20 December 2012); *Joint Mobilization Planning* (22 March 2010).

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### SUMMARY OF CHANGES

Aside from technical, nonsubstantive changes, this version of the bulletin explains the phased-in increased deduction for military retirement and survivor's benefits starting in 2019 until a full deduction is allowable in 2022 and adds additional language relating to federal law changes in 2018 relating to military spouses. In addition, this bulletin has been updated to provide special refund procedures for certain disability severance payments.

## I. INTRODUCTION

### A. 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 subject to tax on all income, regardless of source. Nonresident regular members of the armed forces are subject to tax on all non-military income received from Indiana sources.

### B. 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 income earned as a result of service on involuntary orders or when the person is mobilized and deployed for full-time service, or during the period for which the member's National Guard unit is federalized.

### C. Spouses of Military Personnel

Indiana adjusted gross income tax applies to all income of a domiciled spouse of an armed forces member, regardless of source. However, pursuant to 50 U.S.C. § 4001(c), Indiana adjusted gross income tax does not apply to the earned income of a non-domiciled spouse of an armed forces member. However, if the spouse elects to be treated as an Indiana resident under 50 U.S.C. § 4001(a)(2)(B), the spouse will be subject to Indiana income tax on the spouse's income.

## II. 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 resident or domiciliary of Indiana. However, pursuant to the Military Spouse Residency Relief Act, the spouse of an armed forces member may choose to keep a previous domicile if the service member and spouse had the same domicile or residence prior to moving to Indiana under 50 U.S.C. § 4001(a)(2)(A). Further, for 2018 and later, a spouse of a service member may elect to use the same residence as the service member for

tax purposes pursuant to 50 U.S.C. § 4001(a)(2)(B).

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 or the spouse makes an election under 50 U.S.C. § 4001(a)(2)(B) to claim the same residence outside Indiana as the armed forces member.

### III. 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 non-military (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, compensation for other employment would be attributable to Indiana. Nonresident service members 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 non-military 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.

### IV. 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 the service member earned less than \$5,000 military pay, he or she may deduct only the amount of military pay earned under this deduction. If the taxpayer and spouse are both in the military, they each may claim the deduction.

The service member claims 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 Form IT-40 or IT-40PNR. 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 Form IT-40 or IT-40PNR.

Military retirement pay received by an Indiana resident is taxable in the same manner that it is for federal tax purposes. Beginning in 2018, an individual, or an individual's surviving spouse, is allowed an additional deduction of up to \$6,250 for retirement pay or survivor's benefits received as a result of the individual's active or reserve service in the armed forces. Beginning in 2019, the maximum allowable deduction will increase to \$6,250 plus 25% of the excess beyond \$6,250. The 25% additional allowance will increase to 50% for 2020, 75% for 2021, and 100% for 2022 and later. The individual need not have been an Indiana resident during active military service to qualify for this adjustment.

*Example:* In 2019, Sam received \$7,500 military retirement pay during the year. He is eligible to claim a

maximum Military Retirement Pay Deduction of \$6,563 (\$6,250 plus 25% of \$1,250). He may claim the deduction on Form IT-40 or IT-40PNR.

Military withholding statements or retirement survivor's benefits statements must be enclosed with 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, you can qualify for a separate deduction for both categories. However, if you earn both categories of income in the same year, you cannot use retirement pay and/or survivor's benefits in excess of the limitation to increase your military pay deduction, and vice versa.

### **B. National Guard and Reserve Component Members Deduction**

Service members eligible to claim the National Guard and Reserve Component deduction include members of the Indiana Army National Guard; Indiana Air National Guard; and members of the reserve components of the Air Force, Army, Coast Guard, Marine Corps, Merchant Marine, and Navy.

In calculating Indiana adjusted gross income, these service members may claim the deduction for any combination of periods when they were:

1. On full-time involuntary orders;
2. Mobilized and deployed, either voluntarily or involuntarily, for full-time service; or
3. A member of a unit that was federalized (in the case of a National Guard member).

These service members are entitled to deduct the amount of their qualified military income that was not excluded from their gross income for federal income tax purposes under Section 112 of the Internal Revenue Code. Military withholding statements must be enclosed with the tax return when claiming this deduction.

"Qualified military income" means wages that are paid to a member of the National Guard for any combination of periods when the member is on full-time involuntary orders; the member has been mobilized and deployed, either voluntarily or involuntarily, for full-time service; or the member's unit has been federalized.

"Qualified military income" also means wages that are paid to members of a reserve component of the armed forces of the United States for any combination of periods when the member is on full-time involuntary orders or the member has been mobilized and deployed, either voluntarily or involuntarily, for full-time service.

"Deployment" is defined in Army Regulation 525-93 as "[t]he relocation of forces and [material] to desired operational areas. Deployment encompasses all activities from origin or home station through destination, specifically including intra-continental U.S., inter-theater, and intra-theater movement legs, staging, and holding areas."

"Mobilization" is defined in Joint Publication 4-05, which provides, in pertinent part, "[m]obilization includes assembling and organizing personnel and [material] for active duty military forces, activating the Reserve Component (RC) (including federalizing the National Guard), extending terms of service, surging and mobilizing the industrial base and training bases, and bringing the Armed Forces of the United States to a state of readiness for war or other national emergency." Service members serving on full time orders in an Active Guard and Reserve Program (AGR) are not considered mobilized for purposes of claiming their income as "Qualified Military Income" under [IC 6-3-1-34](#).

### **C. Limitations**

An individual is not entitled to both a Military Service Deduction under [IC 6-3-2-4](#) and a deduction for members of the National Guard and reserve components of the armed forces of the United States for the same qualified military income. In short, one or the other, but not both, of the deductions may be claimed for the same qualified military income in the same taxable year.

Additionally, military income received due to service in a combat zone is not subject to tax on an individual's federal or state income tax return. Because this income is already excluded from Indiana income tax, it is not eligible for the deduction available to members of the National Guard and reserve components of the armed forces of the United States.

*Example:* Brandon is a member of the Indiana Army National Guard. From January through October 15,

Brandon earned \$6,000 from the guard. His unit was federalized on October 16. He earned \$7,000 from that point through December 1. His unit was assigned to a combat zone on December 2, and he earned \$3,000 from then until the end of the year. Brandon's military W-2 shows \$13,000 in Box 1, Wages, tips, and other compensation (the combat zone income is not included in Box 1 because it is not taxable).

Brandon is eligible for both Indiana military deductions. First, he will claim the \$5,000 maximum Military Service Deduction pursuant to [IC 6-3-2-4](#), based on the \$6,000 income earned through October 15. Then, he will claim the National Guard and Reserve Components Deduction of \$7,000 (full amount of income earned after his unit was federalized) pursuant to [IC 6-3-1-3.5\(a\)\(18\)](#). Note: He will not deduct the \$3,000 income earned while stationed in a combat zone because it was not taxed to begin with.

*Example:* Brandon is a member of the Indiana Air National Guard. A member of Brandon's unit is mobilized and deployed for full-time service. However, Brandon is not mobilized and deployed. During the period in which a member of Brandon's unit is mobilized and deployed, Brandon earns \$6,000. Brandon's military W-2 shows \$6,000 in Box 1, Wages, tips, and other compensation.

Brandon is eligible for the Military Service Deduction but not the National Guard and Reserve Components Deduction. First, he will claim the \$5,000 maximum Military Service Deduction pursuant to [IC 6-3-2-4](#), based on the \$6,000 income earned. However, he will not be able to claim the National Guard and Reserve Components Deduction of \$1,000 (\$6,000 minus \$5,000) pursuant to [IC 6-3-1-3.5\(a\)\(18\)](#). Unlike a situation in which a National Guard member's unit has been federalized, the deduction in this scenario applies only if the service member himself or herself is mobilized and deployed.

#### **D. 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)." The spouse claims the deduction on IT-40PNR, Schedule C, line 11. A copy of Schedule IN-2058SP must be included with the return as well.

*Example:* Jack is a domiciliary of Texas. During 2019, 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. A copy of Schedule IN-2058SP must be included with the return as well.

*Example:* Jenny is a domiciliary of Rhode Island. During 2019, 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 unless she makes an election to be treated as a resident of Iowa. If Jenny makes an election to be treated as an Iowa resident, her income will not be subject to Indiana income tax.

#### **V. LOCAL INCOME TAXES**

All Indiana counties have adopted a local income tax. The tax is imposed on residents of adopting counties and out-of-state residents who work or have a principal place of business 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 income tax if they reside in Indiana as of January 1 of the tax year. However, a resident military person who maintains a household outside the state of Indiana is not subject to a local income tax.

The income of a spouse of an armed forces member is not subject to local income 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 and resides in Indiana as of January 1 of the tax year, his or her Indiana earned income is subject to local income tax.

## VI. 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, local income 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 local income 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.

For further information concerning estimated tax, refer to Income Tax Information Bulletin #3, available online at <http://www.in.gov/dor/3650.htm>.

## VII. 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 enclosed with 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 service member 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.

## VIII. SPECIAL RULES FOR COMBAT-INJURED VETERANS TAX FAIRNESS ACT OF 2016

### A. General Provisions

In 2020, the Indiana General Assembly passed SEA 408-2020, which added [IC 6-8.1-9-1\(k\)](#), authorizing a special period for refund claims based on the Combat-Injured Veterans Tax Fairness Act of 2016 (P.L. 114-292). Taxpayers who were eligible to claim federal tax refunds for erroneously-included income under this provision will also be eligible to claim Indiana tax refunds. The provision only applies to disability severance payments made after January 17, 1991, for which Indiana taxes have been (or should have been) withheld, and erroneously included in the taxpayer's Indiana adjusted gross income. Amounts not reported in Indiana adjusted gross income are not eligible for refund.

A claim for refund must be filed between April 1, 2020, and December 31, 2020. If the taxpayer is deceased, a claim for refund may be filed on behalf of the taxpayer by the taxpayer's surviving spouse or estate. If a refund claim was made before April 1, 2020, the refund claim will be treated as if it was filed on April 1, 2020. To claim the refund, please file Form IT-40X for the payment year, reporting the amount of income to be reduced and any amount claimed as a refund. Write "CIVTFA" across the top of the Form IT-40X. In addition, the claim must include the required documents in item (1) or item (2) listed below, and must also include items (3) and (4). In other words, either items (1), (3), and (4) or items (2), (3), and (4) must be provided. The items that must be provided are as follows:

1. A copy of Department of Defense letters 6060-A or 6060-D issued to the taxpayer.
2. If neither letter in item (1) was issued to the taxpayer, a copy of documentation showing the exact amount of and reason for your disability severance payment, such as a letter from the Defense Finance and Accounting Services (DFAS) explaining the severance payment at the time of the payment or a Form DD 214. With the documentation include either a copy of either the VA determination letter confirming your disability or a determination that your injury or sickness was either incurred as a direct result of armed conflict, while in extra-hazardous service, or in simulated war exercises, or was caused by an instrumentality of war.
3. A copy of all Forms 1040X filed with the Internal Revenue Service regarding such payments.
4. Any notice that the Internal Revenue Service has given that a refund claim has been granted or denied, if such information is available.

If the taxpayer filed a claim with the Internal Revenue Service reporting the standard amount of refund allowable by the Internal Revenue Service, the taxpayer may only file a standard refund claim amount with Indiana.

## B. Special Standard Refund Rule

This election is only available if the taxpayer filed a standard federal refund claim. If the taxpayer filed a federal refund claim reporting the actual amount of disability severance pay erroneously included in income, the taxpayer may not use the Indiana standard refund claim. Mark "Standard CIVTFA Claim Amount" across the top of the IT-40X. The same documentation required in subsection (a) is required for the standard state refund claim.

If a taxpayer filed a federal refund claim reporting the standard amount of refund allowable by the Internal Revenue Service, the taxpayer may also claim an Indiana state refund for the following standard amounts if the taxpayer was an Indiana resident for the period in which the disability severance payment was reported as income:

1991-2005	\$400
2006-2010	\$550
2011-2014	\$725
2015-2016	\$700

In addition, a refund of county taxes is available. The refund shall be based on the taxpayer's county of residence in the year in which the disability severance payments are made. The county tax available for refund equals:

Standard refund amount divided by the state tax rate (3.4% for 1991-2014, 3.3% for 2015-2016) times the county tax rate for the year of payment, rounded to the nearest dollar.

## IX. COLLECTION OF OUTSTANDING TAX DEBTS

The federal Servicemembers Civil Relief Act (federal SCRA) and Indiana Servicemembers Civil Relief Act (Indiana SCRA) allow the department to assist active duty military members with the penalty, interest and, if materially affected, the collection activity for outstanding tax debts. To qualify for this relief, the military member must be one of the following:

- An active duty, full-time, service member of the Army, Navy, Air Force, Marine Corps, or Coast Guard;
- Commissioned corps of the National Oceanic and Atmospheric Administration or the Public Health Service if in active duty service status;
- National Guard if called to active service for more than 30 consecutive days for purposes of responding to a national emergency and supported by federal funds; or
- Indiana only: National Guard members that are ordered to active duty.

The federal and Indiana SCRA provide different provisions to those service members that are materially affected and those that are not materially affected. The department will consider all relevant facts and circumstances in determining whether a service member's ability to pay is materially or not materially affected by their active duty status.

More information on this can be found at [www.in.gov/dor/4734.htm](http://www.in.gov/dor/4734.htm). You can also contact the Taxpayer Advocate Office at (317) 232-4692 for more information on the federal SCRA and Indiana SCRA.

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Commissioner

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