TY 2024 State Exercise for Counselors with a Military Certification

Introduction

This exercise is designed to provide a level of comfort training for Tax Counselors who have Military certifications, and therefore are also qualified to prepare state tax returns for active-duty military, who are legal residents of any of the 41 states that have income taxes (and DC). The primary document that will assist in completing this exercise is the Tax Handbook for Active-Duty Military Personnel will be updated Feb 2025.

Three sections in this Handbook will be your primary training aids.

1. State Active-Duty Military Tax Policy Chart (Appendix 4 - Page 17) - a table that shows you at a glance the state category. Either the state:
   - Does not have an income tax - 9 states
   - Totally Exempts Active-Duty Military Pay – 23 states
   - Partially Exempts Active-Duty Military Pay, with conditions – 2 states
   - Does not Exempt Active-Duty Military Pay – 16 states and DC
2. Taxslayer State Return Entries – (Appendix 5 – Pages 18-26) is a comprehensive nine-page table, listing each state that has an income tax. It provides detailed data entries to complete the state return and navigate Taxslayer menus quickly and efficiently. It saves a significant amount of time in completing the state return and ensures that the return is prepared accurately. It explicitly provides instruction for each state - residency form, minimum state administrative information entries, correct exclusion menus to exempt military pay (Subtraction, Deduction, Credit, Adjustment), and explanatory state unique footnotes.
3. Recovering Non-Resident State Tax Erroneously Withheld - (Part 5, P11 and Appendix 6 Pages 27-32) contains information to recover wages erroneously withheld in nonresident states for Active-duty members and nonmilitary spouses.

Use of these three training aids is mandatory.

Set up Scenario

This exercise consists of six typical state practice scenarios. The basic exercise to be used is the Robert and Robin Hood Exercise (Page 132-140) in IRS Pub 6744, VITA/TCE Volunteer Test/Retest. You should have already completed this exercise in Taxslayer when you took the military certification exam. We will use this exercise for all scenarios.

Please make the following additions and assumptions so our focus is exclusively on state military tax situations. Assume that Robert and Robin claim the same state of residence, and that their rental property is in their state of residence. Assume that they are stationed at Fort Belvoir, Virginia (zip code 22060). We will continually change the state residence in these six scenarios.

For each scenario we will provide the state to use, the correct answer, and a commentary.

The following are the correct entries on the 2024 Federal Return:

Wages -$ 33,500: Other Income (Rental) – $8,985; AGI -$ 42,485; EIC - $ 2162; Refund - $ 4334

After completing your state entries, Taxslayer has a feature in the State menu - a print icon that allows you to go directly to the PDF State tax forms. Use this to quickly verify your completed entries on the State tax forms. Then set up your return for the next scenario:

- In the State Section delete the old state and add the new state return – (this will automatically populate the new resident state Personal Information in Taxslayer)
- On the two W-2s (Robert's and Robin's), Block 15 enter the new state. Use same information throughout the exercise for state EIN, and Block 16-17
- Then use Handbook Appendix 5 to complete your state entries (Resident Type, Basic Administrative Information, Military Pay Exclusion, Footnote Remarks)

Scenario 1 – Utah

Correct Answer: State Refund - $ 2,842

Comment: Utah is an easy scenario -- after completing the Residency Type, no administrative or exclusion entries have to be made in Taxslayer. It's ready to go – the calculations have been done. Only a few other states are that easy – most states have administrative or exclusion entries. You should always use the Resident Type indicated on Attachment 5, not the various state definitions in Taxslayer – this will ensure you have the correct state tax form.

Scenario 2 – Kansas

Correct Answer: State Refund - $ 2,501

Comment: Following Attachment 5 leads you to mandatory administrative entries under Basic Information - not tax questions but demographic ones - county of residence and school district. It's important information to Kansas and many other states – and you can't complete the tax return without answering it. Several other administrative questions are asked, but don't have to be answered. Appendix 5 is designed to enable you to efficiently navigate the return and only answer questions you must. Many states ask informational questions they deem important, though they have nothing to do with tax computation. For example, six states (and DC) have mandatory entries regarding Healthcare coverage.

Scenario 3 – New Jersey

Correct Answer: State Refund - $ 2,422

Comment: After reviewing Attachments 3 and 5, you can see that New Jersey is one of five states that requires you to use a Non-resident form even though you are a legal resident. The state policy says it is for administrative purposes only. Use Attachment 5 to navigate Administrative and Exclusion entries. Notice that New Jersey doesn't have any administrative entries, but does have an exclusion entry that needs to be completed, because New Jersey doesn't tax active-duty income. Also note that Robert's Taxable wages are low due to the fact that he was deployed and most of his income is nontaxable (W-2 Block 12 – Code Q – Combat Pay).

Scenario 4 – Louisiana

Correct Answers: State Refund - $ 2624

Comment: Louisiana is one of two states that has a partial exclusion entry (up to $50,000) for military wages. All of Robert's wages can be excluded but Robin's cannot.

Scenario 5 – New Hampshire

Correct Answer: State Balance Due $6 (Rate in 2024 is 3% - New Hampshire is in the process of reducing its annual rate by 1% each year, and will be entirely repealed in 2027).

Comment: New Hampshire is the only state that taxes interest and dividends, no other source of income. For this problem assume that the Hood's received a 1099-INT from Bank of America 118 Storrs St, Concord NH 03301 showing a joint account with $5,000 in Box 1, Interest Income, and enter the form in Taxslayer. EIN is 94-1687062. There are no other interest entries or state withholding.

Also delete the state tax W-2 withholdings for Robert and Robin. Appendix 5 tells you to go to Footnote 7 for specific state instructions. Be sure to verify the state DP 10 Form which shows that the James owe 3% (in 2024) of the amount over $ 4800. You should always check to see if there are applicable footnotes for the resident state.

Scenario 6 – Georgia/Virginia

Correct Answers: Georgia State Refund $ 2,061

Comment: Reinstate the state withholds, and delete the 1099-INT. Completing the Hoods' state return for Georgia is relatively straightforward. There are no administrative or exclusion entries.

However, let's assume that when Robert received his W-2, he saw that his wages had been withheld in error by DFAS in the state of Virginia instead of Georgia. Since Robert was a resident of Georgia for the entire year, he would have to complete a form as a Virginia nonresident to obtain the income erroneously withheld. To do this he would go to Part 5 (2nd paragraph) and follow the process by making the correct entries on the W-2 (Block 15 and 16) for the nonresident state (Virginia - $0 State wages).

Follow the steps in Taxslayer, Exemption 4 to complete the Virginia Form 763-S to obtain wages incorrectly withheld. Note that a paper return is required. Supposing instead of Robert it was Robin who had the money incorrectly withheld by her employer. She would have had to follow a process in Appendix 6, but a different Exemption Category 3. There are many more steps involved, and extensive supporting documentation required by Virginia. All states are required to follow a similar process for spouses under the Military Spouse Residency Relief Act passed in 2009. Incorrect withholding is commonplace for nonmilitary spouses since employers are required by state law to withhold taxes unless a state exemption form is completed annually.

Conclusion

At the start of this exercise, we assumed that the Hoods' rental property was in their resident state. What if this property was in a different income tax state, as is often the case for military personnel? This would have been a different situation because the rental would have resulted in filing a nonresident return due to source income in a nonresident state. You would have been required to prepare for the client, not only a residential state return but a nonresidential state return as well. Our policy is to do only <u>one</u> state return only for the client's <u>resident</u> state. Doing more than one return is very complicated, since there is no standard method for determining tax liability in nonresident states, as well as crediting taxes paid to nonresident states in the resident state. A similar situation applies if an active-duty member had off duty income, for example in Virginia, if Virginia was not the member's resident state.

Our policy is to avoid complicated state returns and do only one resident state return for a client. For the same reason, we avoid doing returns (out of scope) for partial year residency, different state residencies between a taxpayer and spouse, and Married Filing Separately status in community property states, since these situations involve preparing more than one state return. In prior years we faced these types of out-of-scope situations and had to refer clients to a paid provider. We use a Military Intake Sheet (Appendix 1, Page 12-13) to screen out these types of situations in advance of preparing the return.

Hopefully this exercise has given you an appreciation for doing taxes in the other states, and the importance of using the Tax Handbook for Active-Duty Military Personnel. Thank you for doing this exercise and getting a Military certification.