HB 931

Department of Legislative Services

Maryland General Assembly
2001 Session

FISCAL NOTE

House Bill 931 (Delegate Love, *et al.*)
Ways and Means

Income Tax - U.S. Government Employees' Foreign Earned Income

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The bill provides for a subtraction modification under the Maryland income tax for the "foreign earned income" of an individual earned as an employee of the United States or an agency of the United States.

The bill takes effect July 1, 2001 and applies to all taxable years beginning after December 31, 2000.

Fiscal Summary

State Effect: Potential significant general fund revenue decrease beginning in FY 2002. *Under one set of assumptions*, general fund revenues could decrease by approximately $17.7 million in tax year 2001. No effect on expenditures.

Local Effect: Local government revenues would decrease by approximately 2.74% of the total State subtraction.

Small Business Effect: None.

Analysis

Current Law: None applicable.

Background: Under federal law a United States citizen or resident alien living and working abroad may qualify to exclude all or part of his or her foreign earned income from federal income taxes. Foreign earned income is defined as pay, such as wages, salaries, and professional fees, for personal services performed in a foreign country during the time an individual's tax home is in another country. Foreign earned income usually does not include items such as interest, dividends, pensions, annuities, or amounts attributable to employee trusts. To qualify, an individual must meet one of two tests: a bona fide residence test or a physical presence test.

The bona fide residence test may be used by U.S. citizens and certain resident aliens. It provides that the individual must be a resident of a foreign country (or countries) for an uninterrupted period that includes an entire taxable year. This often entails the individual establishing a home and settling in the country with an intention of settling permanently. The physical presence test may be used by any U.S. citizen or resident alien, and requires that the individual be physically present in a foreign country or countries for at least 330 full days during any 12-month period.

If an individual qualifies under either test, then up to $76,000 of foreign earned income may be excluded for federal income tax purposes for tax year 2000. This amount increases by $2,000 per year until it reaches a maximum of $80,000 in tax year 2002 and beyond. An individual working overseas may also be eligible for an additional exclusion for foreign housing costs incurred, within certain limitations.

However, these exclusions for foreign earned income and foreign housing costs are not applicable to income or housing costs that are paid or provided by the U.S. government to its employees.

Under current law, certain Maryland residents serving a military assignment overseas are allowed a State income tax subtraction modification. The amount of the exemption varies depending on the individual's rate of pay. The subtraction includes the first $15,000 of military pay that is: (1) attributable to military service of the individual who is in active service of any branch of the armed forces; and (2) attributable to military service of the individual outside the United States. The amount of the subtraction is reduced dollar for dollar in the amount by which the individual's military pay exceeds $15,000 and is reduced to zero if pay exceeds $30,000.

State Fiscal Effect: The actual cost of the bill cannot be reliably estimated; however, the impact could be significant. The extent of any general fund revenue decrease depends on the number of Maryland residents who are federal employees and who work overseas and their income.

For illustrative purposes only, and based on the following facts and assumptions, general fund revenues could decrease by approximately $17.7 million in tax year 2001:

- In tax year 1998, there was a foreign earned income exclusion on 308,284 federal income tax returns totaling approximately $13.5 billion. The average exclusion was $43,648 per return.

- Average income of overseas government employees will increase by 4% annually.

- Approximately 18.5% of U.S. military personnel are stationed overseas.

- Approximately 5% (6,365) of all Maryland civilian/non-postal federal government employees, would be stationed overseas and therefore be eligible for the subtraction in tax year 2001; the average subtraction is approximately $49,100.

- Approximately 18.5% (3,342) of all U.S. military personnel who are Maryland residents, would be stationed overseas and therefore be eligible for the subtraction in tax year 2001; the average subtraction is approximately $16,750.

Local Fiscal Effect: Local government revenues would decrease by approximately 2.74% of the total State subtraction taken. Based on the assumptions above, this could result in a local revenue decrease of approximately $10.1 million in tax year 2001.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller of the Treasury (Bureau of Revenue Estimates), Department of Legislative Services

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