Department of Legislative Services

Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

House Bill 607 (Delegate Kach)
Ways and Means

County Income Tax - Subtraction Modification and Filing Requirements for Nonresidents

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This bill expands the conditions whereby a nonresident is subject to the county income tax by adding the requirement that in order to be exempt from the tax, any locality in which the nonresident resides may not impose any type of employment-based tax on Maryland residents who are employed in that locality.

The bill takes effect July 1, 2006 and applies to tax year 2006 and beyond.

Fiscal Summary

State Effect: State revenues would not be affected in FY 2007. State income taxes imposed on nonresidents not subject to county income taxes could decrease in FY 2008 and beyond to the extent that localities in Delaware and other states that do not have an income tax reciprocity agreement with the State enact laws that impose indirect taxes on employment that affect Maryland residents. No effect on expenditures.

Local Effect: Local revenues would increase by approximately $8.7 million in FY 2007 and beyond due to increased local income tax revenues imposed on nonresidents. No effect on expenditures.

Small Business Effect: None.

Analysis

Current Law: Counties are required to impose a county income tax at a rate of at least 1% but no more that 3.2% of an individual's Maryland taxable income. A nonresident who derives income from salary, wages, or other compensation for personal services for employment in a county is required to pay county income taxes on this compensation, unless the Comptroller determines that the locality in which the nonresident resides: (1) does not tax the income of a Maryland resident derived from wages for employment in that locality; (2) exempts that income from its tax on income; or (3) allows a credit for that income and exempts the income from its tax withholding requirements.

Background: Any nonresident, except nonresident dependents meeting certain conditions and those with business income or losses, who has Maryland taxable income and is required to file for federal income tax purposes must file a State income tax return. A nonresident who has income or losses derived from a business, occupation, profession, or trade carried on in the State is required to file a State tax return if required to file a tax return for federal purposes, unless the individual is a dependent. Nonresidents whose income attributable to Maryland is comprised solely of wage income are not required to pay State income taxes if they reside in another state that has entered into a reciprocal agreement with the Comptroller's Office whereby the wages of residents of each state earned in the other state are exempt from tax and withholding requirements. Currently, the State has reciprocal agreements with Virginia, Pennsylvania, West Virginia, and the District of Columbia.

The Budget Reconciliation and Financing Act (BRFA) of 2004, Chapter 430, imposed a tax at a rate equal to the lowest county income tax rate in Maryland (currently 1.25%) on individuals who are subject to the State income tax but are not subject to the county income tax. This change applied beginning in tax year 2004. Wage earners who work in Maryland but live in states with which Maryland has an income tax reciprocity agreement – Virginia, Pennsylvania, West Virginia, or the District of Columbia – are not subject to this tax. Nonresidents who work in Maryland but reside in a state that does not have an income tax reciprocity agreement with Maryland are required to pay this tax if they are not otherwise subject to the county income tax. For example, Wilmington (Delaware) imposes a wage tax which applies to nonresidents. Wilmington residents who work in Maryland are required to pay county income taxes and not the special tax. However, residents of other localities in Delaware that do not impose wage taxes who work in Maryland are required to pay the special nonresident tax and not the county income tax. General fund revenues increased by approximately $29 million in tax year 2004 as a result of the special tax. State income taxes imposed on all nonresidents totaled approximately $134.8 million in tax year 2004.

Pennsylvania recently enacted legislation that imposes a local tax that applies to residents and nonresident workers. Act 222 of 2004 amended the Local Tax Enabling Act, Act 511 of 1965, to permit municipalities and school districts (except the City of Philadelphia, the Philadelphia School District, and the Pittsburgh School District) to impose on persons employed within the jurisdiction a combined Emergency and Municipal Services Tax (EMST) of up to a maximum of $52 a year beginning on and after January 1, 2005. The EMST replaces the occupational privilege tax (OPT), which had a maximum annual rate of $10. By comparison, the average State tax filer in Maryland paid approximately $1,439 in county income taxes in 2004.

Municipalities must use funds from an EMST for police, fire, or emergency services; road construction or maintenance; or for the reduction of property taxes. This limitation does not apply to school districts. Act 222 allows local taxing jurisdictions to exempt from the EMST, taxpayers whose income from all sources is less than $12,000. The exemption is optional on the part of the municipality or school district. Local taxing jurisdictions are responsible for refunding taxes withheld from taxpayers who earn less than the low-income exemption. Under current law, a resident of a locality that imposes an EMST tax on Maryland residents would not be required to pay county income taxes for Maryland income tax purposes because the EMST tax is not a direct tax on income as defined under current law. HB 607 proposes to include indirect taxes such as an EMST tax as a type of tax that Maryland residents must be exempted from in order for a nonresident of that locality to be exempted from the county income tax.

State Revenues: This bill would not affect State revenues in fiscal 2007. Legislative Services estimates that only Pennsylvania currently imposes an indirect tax that would apply to Maryland residents who work in the locality. State income taxes are not collected on Pennsylvania residents who work in Maryland pursuant to the states' income tax reciprocity agreement. To the extent that localities in a state that does not have a reciprocal income tax agreement, such as Delaware, enact a tax similar to the EMST tax imposed in Pennsylvania, revenues collected from the tax imposed on nonresidents not subject to the local income tax would decrease as these nonresidents would pay county income taxes in lieu of the special tax on nonresidents.

Local Revenues: Local government revenues could increase significantly in fiscal 2007 due to additional county income tax revenues imposed on nonresidents. The exact amount of increase cannot be reliably estimated, but local income tax revenues could increase by approximately $8.7 million annually beginning in fiscal 2007 based on the following facts and assumptions:

- According to the 2000 Census, an estimated 41,056 Pennsylvania residents worked in Maryland, of which 26,844 worked in Baltimore, Carroll, Frederick, and Washington counties.
- The average annual wage earned by individuals who worked in Maryland was approximately $42,500 according to the Bureau of Labor Statistics.
- An individual with approximately $42,500 in Maryland Adjusted Gross Income had, on average, $29,150 in net taxable income.
- Twenty-five percent of Pennsylvania residents who work in Maryland reside in a locality that imposes an EMST tax.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Pennsylvania Department of Community and Economic Development, Department of Legislative Services

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