



OFFICE OF MANAGEMENT & BUDGET

State Budget Office

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State Fiscal Note for Bill Number:

2025-S 0106

Date of State Budget Office Approval: Monday, March 17, 2025

Date Requested: Friday, January 31, 2025

Date Due: Saturday, February 15, 2025

<i>Impact on Expenditures</i>		<i>Impact on Revenues</i>	
FY 2025	\$0	FY 2025	\$0
FY 2026	\$0	FY 2026	\$(54,647)
FY 2027	\$0	FY 2027	\$(111,217)

Explanation by State Budget Office:

This bill would amend R.I. Gen. Laws § 44-30-12 entitled "Rhode Island income of a resident individual" to add R.I. Gen. Laws § 44-30-12(c)(14), which would create a modification to subtract the amount of a foreign service officer's pension benefits from the taxpayer's federal adjusted gross income. The bill would also define "foreign service officer" by incorporation of a definition from federal regulations. Under current law, the pension benefits of foreign service officers would count toward the individual's federal adjusted gross income and thus would be subject to the personal income tax. However, current law allows a modification for up to \$50,000 of any pension income, which would include the pension income of age-eligible foreign service annuitants up to this amount. This modification was previously \$20,000, but it was increased to \$50,000 starting in TY 2025.

Summary of Facts and Assumptions:

The Department of Revenue, Division of Taxation sent a letter to the Senate Finance Committee in a prior year detailing the technical issues with a previous version of this bill. These issues included (a) the need to clarify who is eligible for the modification due to the multiple federal citations used to define "foreign service officer" in the bill, and (b) the interaction between this proposal and existing military pension and retirement income modifications.

The modification proposed in this bill would be effective for tax years beginning on January 1, 2026.

The amount of a Foreign Service annuitant's benefit is determined predominantly by their years of service and the average salary of their three highest-salary years of service ("high three"). For this analysis, ORA examined the 2025 Foreign Service salary schedules, and assumed that the "high three" of the average retired Foreign Service Officer (FSO) is approximately at the median point of the highest three paygrades and in the median of the "step" progression. Therefore, ORA took the average of the Class 2, Step 7 and Step 8 salaries from the 2025 Foreign Service Overseas Salary Schedule for the locality pay area of Boston-Worcester-Providence, which is \$162,924. The annuity is then based on a percentage of this "high three" salary determined by years of service. Foreign service officers who have reached at least the age of 50 and served at least 20 years are eligible to retire with full annuity benefits. FSOs who are not one of a relatively few selected for the Senior Foreign Service face mandatory retirement at 27 years in service.



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For the purposes of this fiscal note, ORA assumed that the average FSO annuitant has 23.5 years in service, or the midway point between 20 and 27 years. The annuity benefit is 1.7 percent of the "high three" average salary for each year of service up to 20 years, then one percent for each additional year of service over 20. Therefore, the assumed average retired FSO's annuity benefit is 37.5 percent of the "high three" average salary (i.e., $20 * 0.017 + 3.5 * 0.01$). This yields an average annuity benefit for a retired FSO of \$61,096 (i.e., $\$162,924 * 0.375$).

According to the American Foreign Service Association (AFSA), the organization's membership database lists 16 retired FSOs residing in Rhode Island as of February 2024. AFSA estimates its membership includes approximately 25 percent of all Foreign Service retirees. Therefore, ORA estimates that there are 64 Foreign Service retirees currently residing in Rhode Island (i.e., $16 / 0.25$). Current law allows for a modification to adjusted gross income for all taxable pension/annuity benefits for individuals who have reached the minimum age for full Social Security benefits (currently between age 66 and 67, depending on year of birth) and whose federal adjusted gross income does not exceed \$104,200 (\$130,250 if married filing jointly) for the tax year (as of tax year 2024, as these thresholds are inflation adjusted). This modification allows qualifying individuals to subtract up to \$50,000 from their federal adjusted gross income for Rhode Island personal income tax purposes beginning in TY 2025. ORA assumed that half of the Foreign Service annuitants would be of the age to qualify for this existing modification. Therefore, for approximately half of the estimated 64 retired FSOs in Rhode Island, the amount of annuity benefits that count toward the federal adjusted gross income is the full \$61,096.31 calculated above, and for the other half, the amount would be that amount less \$50,000, or \$11,096.31. The total taxable FSO annuity benefits in a given tax year for retired FSOs who are Rhode Island residents would be \$2,310,164. ORA then applied the effective tax rate for resident personal income taxpayers from the ORA personal income tax simulation model using TY 2022 data rebased to TY 2024 tax law. This effective tax rate is 2.963 percent. This produces an estimated total tax liability for all Rhode Island resident FSO annuitants of \$68,448.

ORA assumes this modification would be allowed for both resident and non-resident filers. Turning back to ORA's personal income tax simulation model, ORA calculates the percentage of estimated resident receipts which the \$68,448 in FSO annuity tax liability would represent, using TY 2022 data rebased to TY 2024 law. In this data, resident personal income taxes paid were \$1,348,803,896. The FSO annuity tax liability represents 0.0051 percent of these receipts. Applying this percentage to the TY 2022 personal income tax simulation model's \$304,346,827 in non-resident receipts then yields a non-resident tax liability reduction of \$15,445, for a total reduction of \$83,893. This represents a loss of 0.0051% of personal income tax revenue for TY 2022 under TY 2024 law.

Due to data limitations, this estimated change does not include data from taxpayers who filed paper tax returns. According to the Division of Taxation, the percentage of electronic filers of the total was 91.0% for TY 2022. To account for the paper filers, ORA divided the estimated revenue loss by the percentage of electronic filers to yield an estimated revenue loss from the bill from electronic and paper filers of \$92,190 (i.e., $\$83,893 / 0.91$). Thus, the provisions of the bill indicate that implementation would decrease personal income tax revenues by 0.0056% (i.e., $\$92,190 / \$1,653,150,723$).



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The next step of the analysis is to convert forecasted personal income tax revenues from a fiscal year (which is how budgeted revenue is expressed) to a tax year (representing the results of the modeling). Using a three-year average of FY 2021 - FY 2023, ORA estimated that tax year personal income tax liability represents 95.83% of the following year's total fiscal year personal income tax collected (that is, some fiscal year revenue is due to prior tax years).

The Office of Management and Budget's (OMB) projection of personal income tax revenues for FY 2027 are \$2,045,230,059. ORA applied the 95.83% ratio calculated earlier to the FY 2027 revenue projection to yield TY 2026 personal income tax payments of \$1,959,873,183 realized in FY 2026. ORA then applied the decrease of 0.0056% estimated personal income tax revenue loss from passage of the bill to the estimate of TY 2026 personal income tax revenues to yield estimated forgone personal income tax revenue of \$109,294 in TY 2026 attributable to creating the modification to AGI for Foreign Service pension income.

The percentages described above were also applied to OMB's projection of personal income tax revenues for FY 2028 of \$2,117,186,603 to yield an estimated \$113,140 in decreased personal income tax revenue from passage of the bill in TY 2027.

Employing the Office of Accounts and Control's accrual methodology yields budgetary revenue losses of \$54,647 for FY 2026 (i.e., $0.5 * \$109,294$), and \$111,217 for FY 2027 (i.e., $0.5 * \$109,294 + 0.5 * \$113,140$).

Comments on Sources of Funds:

Personal income taxes are general revenues.

Summary of Fiscal Impact:

FY 2025: Not applicable due to the assumed implementation date of January 1, 2026.

FY 2026: A revenue loss of \$54,647 is forecast.

FY 2027: A revenue loss of \$111,217 is forecast.

Budget Office Signature:

A handwritten signature in blue ink, appearing to read "Joseph Codega".

Digitally signed by Joseph
Codega
Date: 2025.03.17 10:00:22
-04'00'

Fiscal Advisor Signature:

A handwritten signature in blue ink, appearing to be a stylized name.

