Department of Legislative Services

Maryland General Assembly
2021 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 201 (Delegate Palakovich Carr)
Ways and Means

Income Tax Rates – Capital Gains Income

This bill imposes an additional 1% State income tax rate on certain net capital gains included in an individual's Maryland taxable income. **The bill takes effect July 1, 2021, and applies to tax year 2021 and beyond.**

Fiscal Summary

State Effect: General fund revenues increase significantly beginning in FY 2022, reflecting additional personal income tax revenues from imposing the additional net capital gains tax. General fund expenditures may increase by $60,000 in FY 2022 due to one-time implementation costs at the Comptroller's Office.

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Bill Summary: Subject to specified exceptions, the bill imposes an additional 1% State income tax on any amount of net capital gain, as defined and determined under the Internal Revenue Code (IRC).

Exceptions include (1) the sale of a specified residential dwelling that is the individual's primary residence and sold for less than $1 million; (2) specified assets held in a defined contribution plan, defined benefit plan, or similar retirement savings plan; (3) certain sales and exchanges of cattle, horses, and breeding livestock; (4) land subject to or will be subject to certain easements; and (5) property used in a trade or business and qualifies for deduction under Section 179 of the IRC; and (6) affordable housing owned by a nonprofit organization.

Current Law: Maryland conforms to the federal income tax treatment of net capital gains. However, unlike the federal income tax, net capital gains are taxed at the same State tax rates as other income. **Exhibit 1** shows the State income tax rates under current law.

Exhibit 1
Maryland State Income Tax Rates
Current Law

Single, Dependent Filer, Married Filing Separate		Joint, Head of Household, Widower	
Rate	**Maryland Taxable Income**	**Rate**	**Maryland Taxable Income**
2.00%	$1-$1,000	2.00%	$1-$1,000
3.00%	$1,001-$2,000	3.00%	$1,001-$2,000
4.00%	$2,001-$3,000	4.00%	$2,001-$3,000
4.75%	$3,001-$100,000	4.75%	$3,001-$150,000
5.00%	$100,001-$125,000	5.00%	$150,001-$175,000
5.25%	$125,001-$150,000	5.25%	$175,001-$225,000
5.50%	$150,001-$250,000	5.50%	$225,001-$300,000
5.75%	Excess of $250,000	5.75%	Excess of $300,000

Federal Income Tax

Under the federal income tax, gains or losses reflected in the value of a capital asset are generally not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain is generally included in income. The difference between the sale amount and the asset basis is a capital gain or a capital loss. Unless the asset was inherited, the asset basis is typically the purchase price. A gain or loss is treated as long term if the asset is held for more than one year; otherwise it is a short-term gain or loss.

The net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Capital losses are generally deductible in full against capital gains. In addition, a taxpayer may deduct a maximum of $3,000 in net capital losses against ordinary income in each year. Any unused amount of losses may be carried forward indefinitely.

Short-term gains are taxed as ordinary income with a top marginal rate of 37%. Long-term net capital gains are generally taxed under the federal income tax at rates lower than the rates applicable to ordinary income and are equal to 0%, 15%, or 20% depending on the taxpayer's filing status and taxable income.

Special rules apply to the sale of collectibles, investment real estate, a principal residence, and to taxpayers who make qualifying investments within federal opportunity zones.

State Revenues: The bill imposes an additional State income tax rate of 1% on net capital gains income, subject to specified exceptions. As a result, general fund revenues will increase significantly beginning in fiscal 2022.

Imposing a tax on any of the capital gains reported by taxpayers would increase general fund revenues by approximately $150 million annually. The actual revenue gain generated from the bill will be less due to the exceptions specified by the bill. The Comptroller's Office advises that data detailing the sources of capital gains is not available.

Small Business Effect: Small businesses that are partnerships, S corporations, limited liability companies, and sole proprietorships may be meaningfully impacted by the bill. Any of these small businesses with net capital gains would be negatively impacted through increased income tax liabilities. However, the bill exempts the sale of business property if it is deductible under Section 179 of the IRC, which is generally available to smaller size enterprises.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

Information Source(s): Comptroller's Office; Department of Legislative Services

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