Department of Legislative Services

Maryland General Assembly
1999 Session

FISCAL NOTE

House Bill 539 (Delegates Hixson and Barve)
Ways and Means

Qualified Capital Gains - Maximum Tax

This bill creates a tax credit, against both State and local income taxes, of the amount by which the State income tax exceeds the sum of $65,000 and the tax on Maryland taxable income less "qualified capital gains." Qualified capital gains are defined as long-term capital gains less short-term capital losses which would not be taxed if the taxpayer were a non-resident. Therefore, the bill does not exempt capital gains from Maryland-based businesses.

This bill is effective July 1, 1999 and applies to all taxable years beginning after December 31, 1998.

Fiscal Summary

State Effect: Indeterminate but potentially significant general fund revenue loss in FY 2000 and beyond. Expenditures would not be affected.

Local Effect: Local revenues could decline from 30% to 60% of any general fund revenue loss. Expenditures would not be affected.

Small Business Effect: Potential meaningful effect.

Fiscal Analysis

Background: The credit created by this bill affects those taxpayers with qualified capital gains (long-term capital gains less short-term capital losses which would not be taxed if the taxpayer were a non-resident) of $1,340,206 or more. The credit has the effect of capping the gains subject to tax at this amount in tax year 1999. As the top tax rate declines through 2002, the cap will increase to $1,368,421. **Exhibit 1** demonstrates several examples of how the credit operates.

Exhibit 1
Examples of Effect of HB 539 in Tax Year 1999

	Taxpayer A	Taxpayer B	Taxpayer C	Taxpayer D
Total Taxable Income	$1,500,000	$1,500,000	$2,000,000	$2,000,000
Qualified Capital Gains	1,000,000	1,400,000	1,400,000	1,800,000
Other Taxable Income	500,000	100,000	600,000	200,000
State Taxes	72,695	72,695	96,945	96,945
$65,000+Tax on Other Taxable Income	89,195	69,795	94,045	74,645
Amount of Credit	0	2,900	2,900	22,300
Net Taxes Paid	72,695	69,795	94,045	74,645
Value of Credit in Terms of Taxable Income	$0	$59,794	$59,794	$459,794

Taxpayer A does not receive a tax credit, because qualified taxable gains are less than $1.3 million. Taxpayers B and C receive the same credit, $2,900. This credit equates to exempting $59,794 of income from tax, which is the amount by which their qualified capital gains exceed $1,340,206. Taxpayer D, with the same total taxable income as taxpayer C, receives a $22,300 credit. This equates to exempting $459,794 of income from tax, which again is the amount by which qualified capital gains exceed $1,340,206.

State Revenues: This bill would result in an indeterminate but potentially significant general fund revenue loss. **Exhibit 2** below presents the range of possibilities using tax year 1995 and 1996 data. The calculation applies the tax year 1999 top marginal rate of 4.85% to the prior years' information and assumes that all of the capital gains are "qualified." Since non-residents are required to pay State tax on capital gains derived from Maryland-based businesses or property, under the bill, these forms of capital gains would be taxed. The portion of capital gains attributable to gains derived from Maryland-based businesses or property cannot be determined at this time; any such gains, however, will reduce the revenue impact.

Exhibit 2
Potential Revenue Loss to the State

	Tax Year 1995	Tax Year 1996
Number of Returns	91	231
Average Taxable Income	$3,302,780	$5,828,100
Average Capital Gains	$2,809,747	$5,429,242
Average Other Taxable Income	$493,033	$398,857
Average State Tax Liability	$160,129	$282,607
$65,000 + Tax on Other Taxable Income per Return	$88,857	$84,289
Amount of Credit per Return	$71,273	$198,318
Net Taxes Paid per Return	$88,857	$84,289
Total Cost to the State	$6,485,816	$45,811,527

State Expenditures: The Office of the Comptroller advises that $46,400 of expenditures would be incurred for programming changes to the tax processing system and $1,100 of expenditures would be incurred for form and instruction changes in fiscal 2000. The Department of Legislative Services advises that economies of scale regarding computer programming changes could be realized, since there will be changes to the income tax processing system due to the 1997 income tax reduction which is phased in through 2002. Additionally, since forms and instructions are updated annually, these costs could be incurred within existing budgeted resources.

Local Revenues: Since this credit serves to reduce both State and local income taxes, piggyback taxes would be reduced. Since this credit would be claimed by very few taxpayers, however, the actual piggyback loss could range from 30% to 60% of the State loss (based on a $1,200 personal exemption and a 5% top tax rate), depending on the counties of residence of taxpayers claiming this credit.

Small Business Effect: Small businesses filing individual income tax returns with capital gains over $1,340,206, if any, could realize a substantial reduction in State and local income taxes.

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

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lnc/jr

Analysis by: Lina Walker

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 946-5510
(301) 970-5510