SB 329

Department of Legislative Services

Maryland General Assembly
2002 Session

FISCAL NOTE

Senate Bill 329 (Senator Haines, *et al.*)
Budget and Taxation

Income Tax - Capital Gains

This bill creates a subtraction modification of 50% of the first $50,000 of any net capital gains for both individual and corporate income taxes. The amount of the modification is reduced, but not below zero, by any part of net capital gains excluded from federal adjusted gross income for federal income tax purposes. Tax preference items must be modified by adding the amount of the subtraction allowed by this bill.

The bill takes effect July 1, 2002 and applies to all taxable years beginning after December 31, 2001.

Fiscal Summary

State Effect: General fund revenues could decline by an estimated $102.5 million in FY 2003 and $74.2 million in FY 2004. Special fund revenues could decline by $189,800 in FY 2003. The revenue loss in FY 2003 contains one and one-half years of personal income tax loss due to the effective date of this bill. Out-year reductions increase by about 2% annually. Potential increase in expenditures for alteration of tax forms.

($ in millions)	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
GF Revenue	($102.5)	($74.2)	($81.5)	($89.6)	($96.2)
SF Revenue	(.2)	(.2)	(.2)	(.2)	(.2)
GF Expenditure	-	-	-	-	-
Net Effect	($102.7)	($74.3)	($81.7)	($89.8)	($96.4)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local revenues could decline by an estimated $56.1 million in FY 2003. Expenditures would not be affected.

Small Business Effect: Potential meaningful.

Analysis

Current Law: No income tax subtraction modification is allowed for capital gains.

Background: The Internal Revenue Code (IRC) defines the following:

A *capital asset* is property held by a taxpayer, whether or not connected with a trade or business, with specified exceptions, including stock in trade properly included in inventory, depreciable business property, real property used in the taxpayer's business, and copyrights.

Short-term capital gain is the gain from the sale or exchange of a capital asset held for less than one year, if and to the extent the gain is taken into account when computing gross income.

Short-term capital loss is the loss from the sale or exchange of a capital asset held for less than one year, if and to the extent the gain is taken into account when computing taxable income.

Long-term capital gain is the gain from the sale or exchange of a capital asset held for more than one year, if and to the extent the gain is taken into account when computing gross income.

Long-term capital loss is the loss from the sale or exchange of a capital asset held for more than one year, if and to the extent the gain is taken into account when computing taxable income.

Net short-term capital gain is the excess of short-term capital gains for the taxable year over the short-term capital losses for the year.

Net short-term capital loss is the excess of short-term capital losses for the taxable year over the short-term capital gains for the year.

Net long-term capital gain is the excess of long-term capital gains for the taxable year over the long-term capital losses for the year.

Net long-term capital loss is the excess of long-term capital losses for the taxable year over the long-term capital gains for the year.

Capital gain net income is the excess of the gains from the sales or exchanges of capital assets over the losses from such sales or exchanges.

Net capital loss is the excess of the losses from sales or exchanges of capital assets over a specified sum allowed.

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.

The neighboring states of Virginia, New Jersey, West Virginia, and Delaware, and the District of Columbia, use federal adjusted gross income as the staring point for the state income tax and do not provide any adjustment for capital gains when calculating the state income tax. Pennsylvania does not use federal adjusted gross income as its starting point, but rather taxes different classes of income (wages, capital gains, for example) at the same rate. However, a capital loss may be used to reduce a capital gain, but not another class of income.

State Fiscal Effect: Based on tax year 1999 income tax data, allowing this capital gains subtraction could reduce individual income tax revenues by $101.9 million in fiscal 2003, and $73.7 million in fiscal 2004. The fiscal 2003 loss includes one and one-half years of the effect of this bill, because subtractions taken in all of tax year 2002 and half of 2003 will be accounted for in fiscal 2003.

Assuming that all corporations with net capital gains will have at least $50,000 of net capital gains, the total capital gains subtraction from corporate income would be $9.0 million in tax year 2002. The revenue loss at the 7% corporate income tax rate would be $629,620. For the first tax year, 95% of this loss will be realized in the second fiscal year (fiscal 2003) and 5% in the third fiscal year (fiscal 2004). In succeeding years, 25% of the loss will be realized in the first fiscal year, 70% in the second, and 5% in the third. Consequently, the fiscal 2003 revenue loss would be $759,165 and the fiscal 2004 loss would be $647,081. Out-year losses grow by 10%.

About 25% of corporate income tax revenues are distributed to the Transportation Trust Fund (TTF); the remainder is credited to the general fund. The general fund would therefore lose $569,373 in fiscal 2003 and the TTF would lose $189,791. In fiscal 2004, the general fund loss would be $485,311 and the TTF loss would be $161,770. Future year revenue losses increase by approximately 2% for both the general fund and the TTF.

Combining the personal and corporate income tax revenue loss, the general fund would lose approximately $102.5 million in fiscal 2003 and $74.2 million in fiscal 2004. TTF revenues would decline by $189,791 and $161,770, respectively.

The Office of the Comptroller advises that if this subtraction modification is added to the income tax form as a miscellaneous subtraction, any changes to the forms and instructions could be absorbed with existing resources.

However, if an additional line is added to the tax returns, expenditures could increase by $170,260 in fiscal 2003. This would include charges for artwork, printing and postage and a one-time computer programming charge of $64,400 in fiscal 2003.

At this time, it is not known how this subtraction would be added to the income tax returns.

Local Revenues: Local government revenues would decline by approximately $56.0 million in fiscal 2003 and $40.5 million in fiscal 2004 (approximately 55% of the State revenue loss). Local governments will also lose about $56,900 in fiscal 2003 and $48,500 in fiscal 2004 from the TTF distribution to local governments.

Small Business Effect: Those small businesses with capital gains, including gains from investments and real property, would realize greater after-tax returns since up to $25,000 of gains would be tax exempt.

Additional Information

Prior Introductions: This bill was introduced as SB 6 in the 1999 session, SB 620 in the 1998 session, SB 453 in the 1997 session, SB 70 in the 1996 session, and SB 30 in the 1995 session. These bills received an unfavorable report from the Budget and Taxation Committee each year.

Cross File: None.

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

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