HB 956

Department of Legislative Services

Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

House Bill 956 (Delegate Gutierrez, *et al.*)
Ways and Means

Income Tax - Capital Gains

This bill imposes an additional 2% State income tax rate on the net capital gains included in an individual's Maryland taxable income.

The bill takes effect July 1, 2012, and applies to tax year 2012 and beyond.

Fiscal Summary

State Effect: General fund revenues increase by at least $211.0 million in FY 2013, reflecting revenues from one and one-half tax years. Future year estimates reflect annualization and the current income tax revenue forecast. No effect on expenditures.

($ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	$211.0	$156.3	$168.5	$181.8	$196.6
Expenditure	0	0	0	0	0
Net Effect	$211.0	$156.3	$168.5	$181.8	$196.6

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

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

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-$150,000	4.75%	$3,001-$200,000
5.00%	$150,001-$300,000	5.00%	$200,001-$350,000
5.25%	$300,001-$500,000	5.25%	$350,001-$500,000
5.50%	Excess of $500,000	5.50%	Excess of $500,000

Background:

Federal Income Tax

The federal income tax treatment of capital gains has changed significantly over the last few decades. The current federal taxation of long-term capital gains at lower rates than ordinary income has been the focus of significant attention among policymakers.

Under the federal income tax, gains or losses reflected in the value of an 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 – which is typically the purchase price – is a capital gain or a capital 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. Gain or loss is treated as long-term if the asset is held for more than one year.

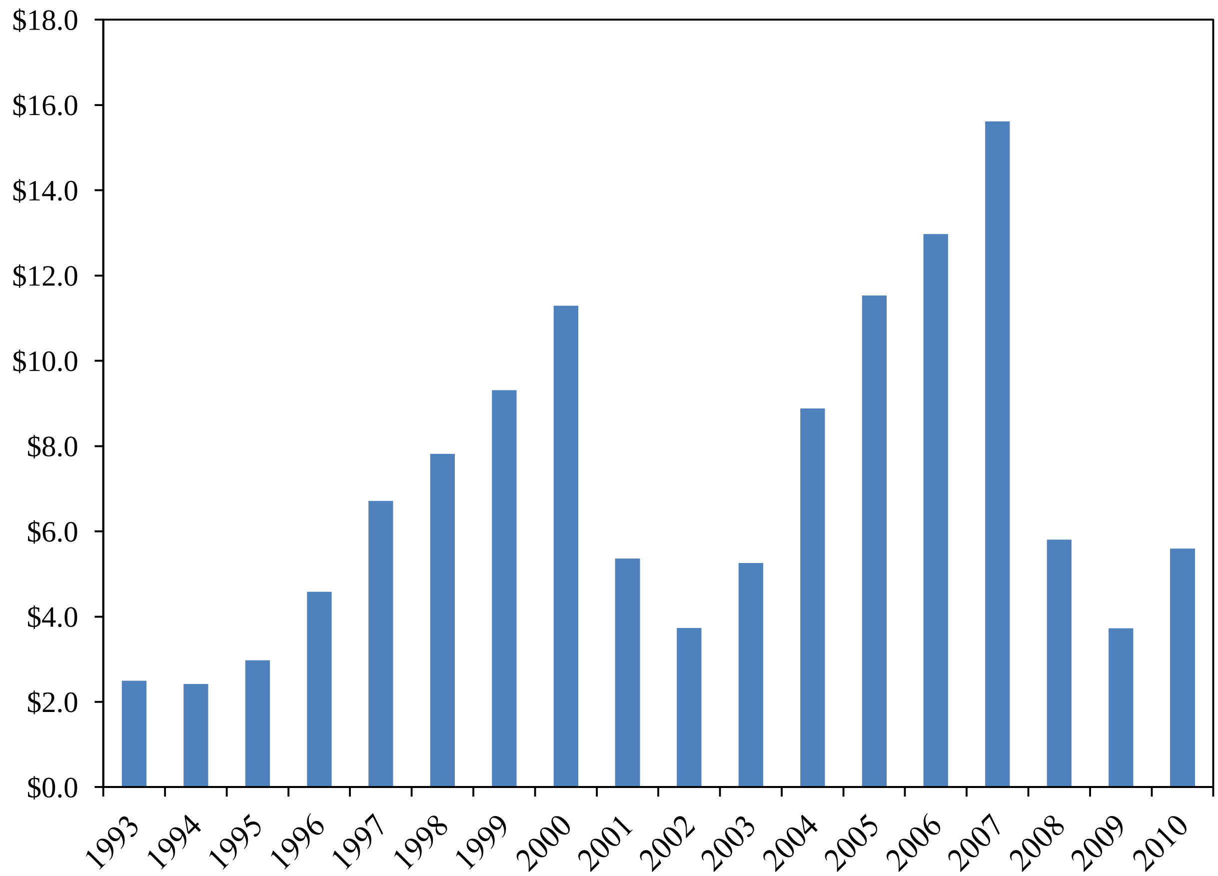
Any long-term net capital gain of an individual is generally taxed under the federal income tax at rates lower than the rates applicable to ordinary income. Recent federal legislation extended the lower rates of taxation on these capital gains through tax year 2012.

Capital losses are generally deductible in full against capital gains. In addition, a taxpayer may deduct capital losses against up to $3,000 of ordinary income in each year. Any unused amount of losses may be carried forward indefinitely.

Maryland Capital Gains

The amount of net capital gains reported by Maryland taxpayers has varied significantly over time, reflecting economic cycles and the volatility of asset markets. **Exhibit 2** shows the amount of net capital gains reported in tax years 1993 through 2010; the average annual change in net capital gains during this period (positive or negative) was 30%. The variation in net capital gains over time also contributes to the overall volatility of income tax revenues – capital gains push up tax revenues while capital gains revenues are increasing and contribute to greater revenue declines in economic downturns. For example, State and local income tax revenues decreased by approximately 11% from tax year 2007 through 2009. However, had capital gains income decreased at the same rate as all other income, the revenue decrease over this time period would have been only 4%.

Exhibit 2
Net Capital Gains – Tax Year 1993-2010
($ in Billions)



Note: Net capital gains reported on resident returns not including fiduciaries and nonresident returns.

Source: Internal Revenue Service, Comptroller's Office

State Revenues: The bill imposes an additional State income tax rate of 2% on net capital gains income. As a result, general fund revenues increase by at least $211.0 million in fiscal 2013, which reflects the impact of one and one-half tax years. Future year revenues grow at the current forecasted growth rate for net capital gains.

This estimate is based on the amount of net capital gains reported on resident returns. It does not include additional tax revenues that result from the tax imposed on income reported on nonresident returns. Accordingly, revenue increases will be greater than estimated as a result of additional capital gains taxes paid by these taxpayers.

Small Business Effect: Small businesses that are partnerships, S corporations, limited liability companies, and sole proprietorships would be meaningfully impacted by the bill. Any of these small businesses with net capital gains would be negatively impacted through increased income tax liabilities.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Internal Revenue Service, Joint Committee on Taxation, Department of Legislative Services

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ncs/jrb

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