Department of Legislative Services

Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE

House Bill 240 (Delegate James)
Appropriations

Operating Budget - Capital Gains Tax Revenue - Appropriation to Revenue Stabilization Account

This bill requires the Governor, beginning in fiscal 2015, to include in the annual budget bill an appropriation to the Revenue Stabilization Account equal to the amount of any State income tax revenue from capital gains received as of June 30 of the second preceding fiscal year over $500.0 million. This appropriation is in addition to an existing general fund appropriation that must be made to the account in accordance with specified statutory provisions.

The bill takes effect July 1, 2013.

Fiscal Summary

State Effect: Since State income tax revenue from capital gains is not projected to exceed $500.0 million over the next five years, the bill is not expected to affect State finances. However, to the extent capital gains tax revenue exceeds $500.0 million, Revenue Stabilization Account revenues increase significantly; any such increase cannot be reliably estimated at this time.

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: The State Reserve Fund provides a means to designate monies for future use. It is a general description for four individual accounts: the Revenue Stabilization Account (Rainy Day Fund); the Dedicated Purpose Account; the Catastrophic Event Account; and the Economic Development Opportunities Program Account (Sunny Day Fund).

The Revenue Stabilization Account was established in 1986 to retain State revenues to meet future needs and to reduce the need for future tax increases by moderating revenue growth. The account consists of direct appropriations in the budget bill and interest earned from all State Reserve Fund accounts.

If the account's fund balance is between 3.0% and 7.5% of projected general fund revenues, the Governor must include in the budget bill at least $50.0 million or whatever amount is required for the account balance to exceed 7.5% of estimated general fund revenues for that year. If the account fund balance is below 3.0% of the estimated general fund revenues for that fiscal year, an appropriation of at least $100.0 million must be made to the account.

If the account's balance exceeds 7.5% of projected general fund revenues, the Governor is not required to include additional funds for the account in the budget bill.

The Governor may transfer funds from the account to the general fund as necessary to support the operation of State government on a temporary basis, if the transfer (1) does not result in an account balance below 5.0% of the estimated general fund revenues for the fiscal year in which the transfer is made and (2) is authorized by either an Act of the General Assembly or the State budget bill as enacted. However, if the transfer would result in an account balance below 5.0% of the estimated general fund revenues for the fiscal year in which the transfer is made, the Governor may transfer funds only if the transfer is authorized by an Act of the General Assembly other than the State budget bill.

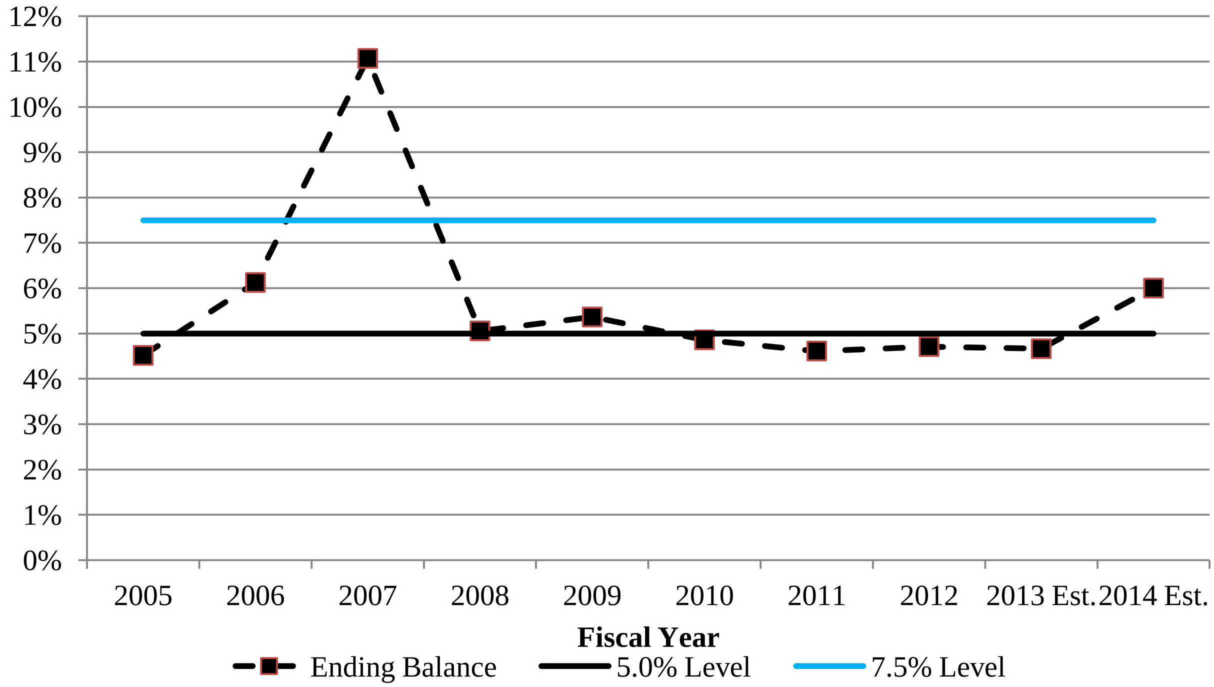
The Governor must appropriate an amount equal to any unappropriated general fund balance at closeout from the second preceding fiscal year in excess of $10.0 million into the account. This appropriation to the account is referred to as the "sweeper provision." This appropriation must be made to the budget two years after the unappropriated general fund surplus is realized but may be reduced by a required appropriation to the State transfer tax special fund.

Background:

Revenue Stabilization Account

Over the last decade, the State has maintained at least the required balance of 5.0% of estimated general fund revenues in the Revenue Stabilization Account. Balances peaked in fiscal 2007 when unexpected revenue attainments were appropriated to the account. Although legislation was enacted to establish a funding goal of 7.5%, balances above 5.0% have been used annually to mitigate persistent general fund shortfalls. **Exhibit 1** illustrates the balance in the account from fiscal 2005 through 2012 and the projected balance for fiscal 2013 through 2014 relative to the percentage of general fund revenues.

Exhibit 1
Revenue Stabilization Account End-of-year Balances
Relative to Percentage Benchmarks
Fiscal 2005-2014

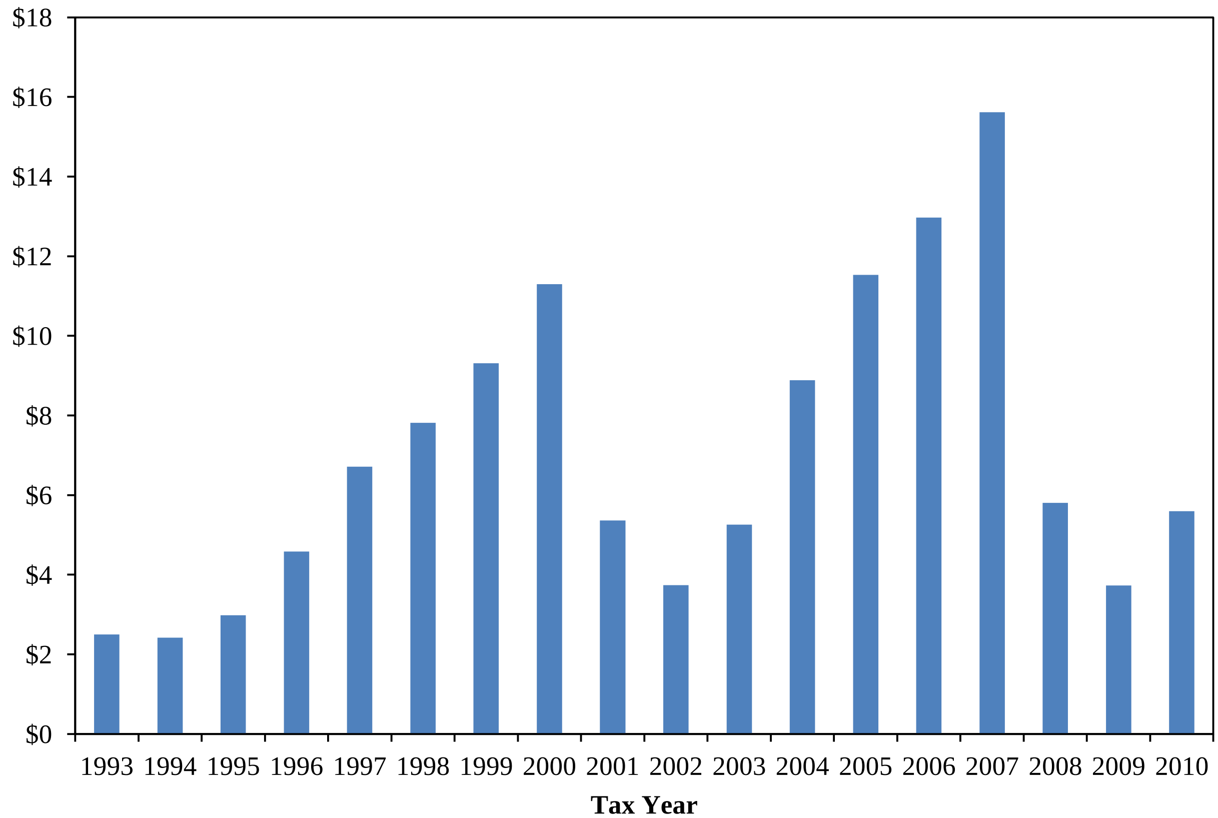


Source: Department of Budget and Management

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



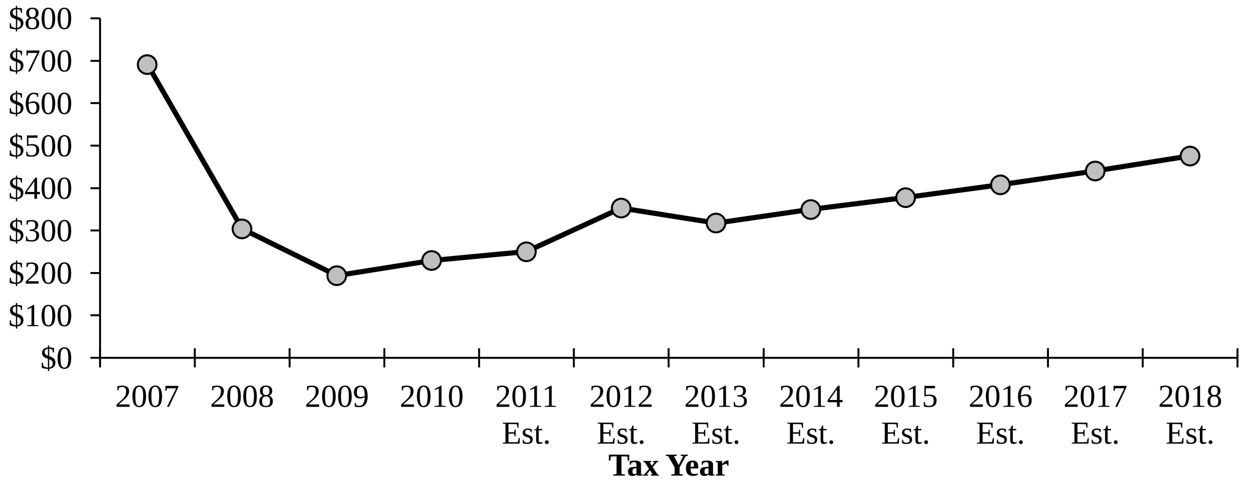
Note: Net capital gains reported on resident returns, not including fiduciaries and nonresident returns.

Source: U.S. Internal Revenue Service; Comptroller's Office

Exhibit 3 provides actual and estimated State income tax revenue from capital gains in tax years 2007 through 2018. The effective tax rate was calculated by dividing total net State tax by the total net taxable income and making additional adjustments in tax year 2008 and subsequent years to reflect the distribution of capital gains income across income levels. The data does not reflect revenue collected from nonresidents and fiduciaries with Maryland capital gains income. While State capital gains income exceeded $500.0 million in tax years 2006 and 2007, it is not projected to exceed $500.0 million prior to tax year 2018.

Massachusetts requires state income tax revenue from capital gains in excess of $1.0 billion to be transferred to the state rainy day fund. Washington requires that any revenue growth that exceeds the five-year average by more than one-third be deposited in the state's rainy day fund.

Exhibit 3
State Income Tax Revenue from Capital Gains – Tax Year 2007-2018
($ in Millions)



Source: Comptroller's Office; U.S. Internal Revenue Service; Department of Legislative Services

Additional Comments: Implementing the bill may be difficult because (1) capital gains information is reported on federal tax forms, not State tax forms, and is not usually available until 18 months after the end of the tax year and (2) the bill's requirements impact State fiscal years and income tax information is provided on a tax-year basis.

Additional Information

Prior Introductions: HB 1439 of 2012 received a hearing in the House Appropriations Committee, but no further action was taken.

Cross File: None.

Information Source(s): Department of Budget and Management, Comptroller's Office, Center on Budget and Policy Priorities, Department of Legislative Services

Fiscal Note History: First Reader - January 31, 2013
ncs/ljm

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