HB 222

Department of Legislative Services

Maryland General Assembly
2020 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 222 (Delegate Palakovich Carr, *et al.*)
Ways and Means

Income Tax Rates - Capital Gains Income

This bill imposes an additional 1% State income tax rate on the net capital gains included in an individual's Maryland taxable income. **The bill takes effect July 1, 2020, and applies to tax year 2020 and beyond.**

Fiscal Summary

State Effect: General fund revenues increase by $120.9 million in FY 2021, reflecting additional personal income tax revenues from imposing the additional net capital gains tax. Future year estimates reflect the forecasted growth in capital gains. No effect on expenditures.

($ in millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
GF Revenue	$120.9	$181.6	$158.6	$153.5	$151.7
Expenditure	0	0	0	0	0
Net Effect	$120.9	$181.6	$158.6	$153.5	$151.7

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

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-$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

Background:

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.

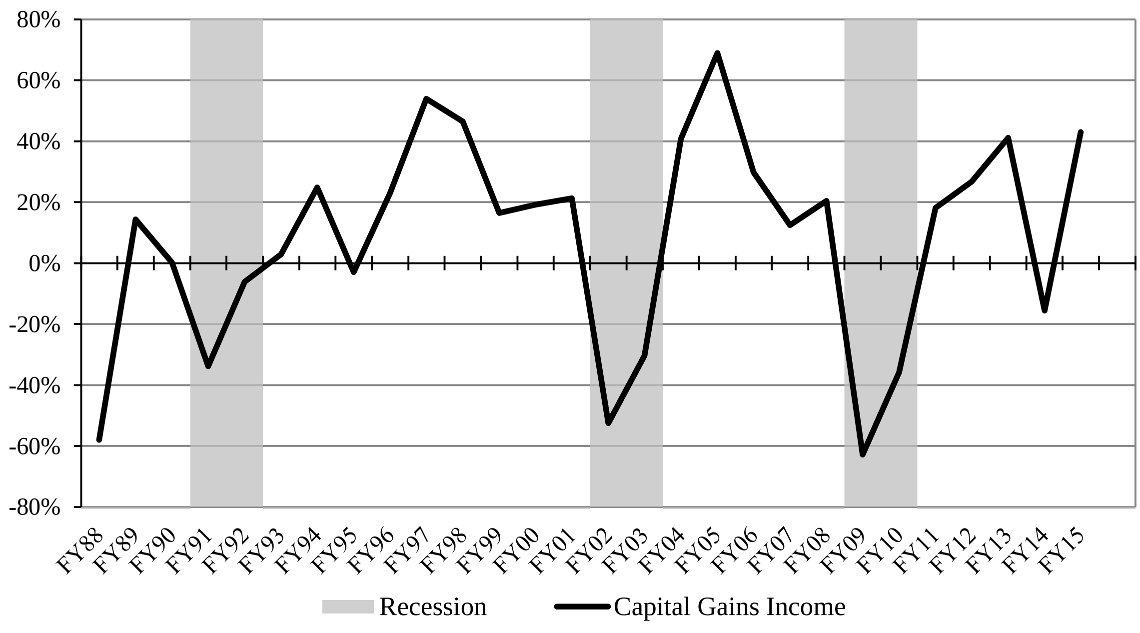
Special rules apply to the sale of collectibles, investment real estate, a principal residence, and to taxpayers who make qualifying investments within federal opportunity zones.

An additional tax of 3.8% is generally imposed on the net investment income of individuals, estates, and trusts with incomes in excess of a threshold. For individuals, the tax applies to the taxable capital gain of individuals whose modified adjusted gross income exceeds $200,000 ($250,000 for married filing jointly).

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 annual percentage change in net capital gains over time and the influence of economic cycles on these gains.

Exhibit 2
Annual Percentage Change in Net Capital Gains
Fiscal 1988-2015



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

Source: Internal Revenue Service; Comptroller's Office

Capital Gains Taxation in Other States

Most states tax capital gains at the same rate as ordinary income. A number of states allow taxpayers to partially or fully exempt capital gains and/or tax the gains at lower rates. Other states exempt the capital gains generated for the sale of certain in-state businesses or assets.

Of the nearby jurisdictions, most states conform to the federal treatment of capital gains and tax gains as ordinary income. New Jersey and Pennsylvania impose limitations on the capital losses that can be claimed in the tax year. Virginia excludes the gain resulting from land sales for open space and from certain in-state technology companies.

State Revenues: The bill imposes an additional State income tax rate of 1% on net capital gains income. As a result, general fund revenues increase by $120.9 million in fiscal 2021.

This estimate is based on the amount of net capital gains reported on resident returns and the current income tax forecast growth for capital gains. It also reflects the amount of net capital gains reported by fiduciaries in tax years 2010 through 2014, the last year of available data. Data on the amount of net capital gains realized by nonresidents is not available. Accordingly, revenue increases may 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: HB 956 of 2012, a similar bill, received a hearing in the House Ways and Means Committee, but no further action was taken.

Designated Cross File: None.

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

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