Feb. 9, 2023

The Honorable Vanessa Atterbeary
Ways & Means Committee
House Office Building
Annapolis, MD 21401

RE: HB 337, “Income Tax – Capital Gains, Dividends, and Foreign–Derived Intangible Income – Alterations” - **UNFAVORABLE**

Dear Chair Atterbeary and members of the committee,

The Maryland Association of CPAs’ State Tax Committee is composed of CPA members with expertise in the area of state and local tax. We encourage in-depth analysis of the issues, undertaken through an organized and logical process with the goal of enacting good tax policies.

With this in mind, we wish to offer the following comments related to HB 337: A) All capital gains are already subject to the highest marginal Maryland income tax rate; plus, there are severe administrative problems with administering such a provision, outlined below. B) The several provisions in the bill related to removing deductions pertaining to activities conducted in a foreign country are likely unconstitutional under a decision of the United States Supreme Court, cited below.

A. The capital gains additional tax rate is bad tax policy for a number of reasons, including the fact that all capital gain income is already subject to the highest marginal Maryland income tax rate — i.e., there is no preferential rate. Additionally, the provision will be difficult to administer:

1. As written, it appears this extra tax would apply to **everyone**, as opposed to those only in the highest Maryland bracket.

2. The bill lacks a clear definition of “capital gains.”
    a. If a part-year Maryland resident had a capital gain allocated to another state, is that excluded, since that gain is pulled from Maryland income?
    b. As for the principal residence gain exclusion: What if a home is sold for $950,000 and the gain is $700,000, thus taxable at the federal and Maryland level on a joint return? It would seem this gain is excluded for purposes of this tax. If the sale price is $10,000,000 and the gain is $500,000, is the surtax not owed since the gain is not reported on the 1040?

c. Does “*net capital gain as defined under the IRC*” include IRC 1231 gain, which is trade or business income with a preferential rate? How would IRC 1231 recapture impact this Maryland calculation?

3. Under HB 337, compliance would be extremely complex and require a separate calculation / worksheet to compute the surtax.
4. It is unclear what amount of capital gain is *not* subject to this surtax.
5. HB 337 would incentivize someone nearing retirement or the sale of capital assets to move out of state before the transaction occurs.
6. Keep in mind that for most Maryland taxpayers who would be subject to this surtax, they are not deducting much, or any, of their Maryland income tax anymore. This surtax would increase their state tax on included gains by 11%. Further, quite often, capital gains are subject to an additional federal tax under the Internal Revenue Code – Section1411 – in the amount of 3.8%.
7. Very few other states tax capital gain income at a higher rate than ordinary income. In fact, about 10 states tax capital gain at lower rates than ordinary income.

B. The provisions of the bill related to additional modifications — that is, the disallowance of the listed deductions, related to activities conducted in foreign countries — are likely unenforceable as being unconstitutional as violations of the Commerce Clause. Simply put, the states are not permitted to discriminate against foreign commerce in favor of in-state / U.S. commerce. The United States Supreme Court, in its decision in *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance,* 505 U.S. 71 (1992), ruled that Iowa’s tax code contained such a discriminatory provision where the state statute followed the federal Internal Revenue Code by allowing a deduction for dividends from a U.S. company but the state did not allow a deduction or credit for dividends from a foreign company – the same provision, among similar others, that HB 337 proposes that Maryland adopt, in violation of the Constitution and the Supreme Court’s ruling.

MACPA’s State Tax Committee supports efforts to reduce complexity and improve compliance in Maryland’s tax law. Therefore, for the reasons noted, we must respectfully request an unfavorable report for HB 337.

We appreciate the opportunity to provide these comments. Should you have questions, please contact Mary Beth Halpern at the MACPA office at marybeth@macpa.org or (443) 632-2330.

Sincerely,

MACPA State Tax Committee

cc: Nick Manis, Manis Canning & Associates