TESTIMONY OF

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DEPARTMENT OF ADMINISTRATIVE AND FINANCIAL SERVICES

Before the Joint Standing Committee on Taxation

Hearing Date: *March 26, 2025*

LD 1047 – "*An Act to Impose an Additional Tax on Certain Unearned Income*"

Senator Grohoski, Representative Cloutier, and members of the Taxation Committee – good morning, my name is Michael Allen, Associate Commissioner for Tax Policy in the Department of Administrative and Financial Services. I am testifying at the request of the Administration Against LD 1047, "*An Act to Impose an Additional Tax on Certain Unearned Income.*"

For tax years beginning on or after January 1, 2025, the bill imposes a tax on individuals equal to 4% of capital gains exceeding $250,000 for single individuals or married individuals filing separately; $375,000 for heads of households; or $500,000 for married persons filing jointly or as surviving spouses. This tax is in addition to the existing Maine individual income tax imposed on capital gains. This 4% surtax would give Maine one of the highest marginal tax rates (11.15%) on capital gains in the nation and that rate would begin at comparatively low-income thresholds.

The timing of capital gains income is highly discretionary, and the income is concentrated in a small number of taxpayers causing it to be a volatile source of income for the State. This volatility would increase the challenge of managing the State's fiscal position and would likely increase the size of a revenue shortfall during an economic downturn.

Progressive income tax rate structures serve an important role in creating a fair and balanced state tax structure and a recent report by the Institute on Taxation and Economic Policy ranked Maine as one of the most progressive states in the country, with only five states being ranked as more progressive. This is in part due to the recent expansions of Maine's income tax credits specifically aimed at helping low-income Mainers. These Expansions were accomplished without income tax rate increases such as this one.

Under federal law, a long-term capital gain or loss arises from the disposition of capital assets held for more than one year; any other capital gain or loss is considered short-term. Net capital gain is the amount by which a taxpayer's net long-term capital gain for the year is more than the taxpayer's net short-term capital loss. The net capital gain is subject to special maximum tax rates at the federal level that are generally lower than the tax rates that apply to the taxpayer's other income. For 2024, the federal maximum rates applicable to net capital gains are either 0%, 15%, or 20% for most assets held for more than a year. In addition, there is a federal 3.8 percent Net Investment Income Tax on taxpayers whose income exceeds certain threshold.

Unlike the federal income tax, Maine does not provide favorable lower tax rates to long-term capital gains and instead taxes these long-term gains at the same rates that apply to taxable income generally.

If the Committee moves forward with this bill, applying the new tax rate to tax years beginning on or after January 1, 2026 is recommended for policy, compliance, and administrative reasons.

The Administration also notes the following technical concerns:

- The bill does not, in the case of nonresident individuals, limit the tax to income from capital gains derived from sources in Maine. MRS continues to consider the apportionment method utilized.
- The bill should clarify the phrase "income derived from capital gains."
- The bill does not apply to earnings from capital gains by estates, trusts, or corporations, but would apply to individuals who are members of a pass-through entity.
- The income thresholds are not adjusted for inflation in the same manner as the individual income tax rate brackets.

The preliminary estimated fiscal impact of this bill is a revenue increase of $45 to $55 million per year.

The preliminary estimated administrative costs are under consideration. Computer programming costs will be required to develop a worksheet and add a line for the additional tax on the individual income tax return. Unless the application date of the bill is changed to tax years beginning on or after January 1, 2026, the bill will require additional printing and mailing costs to update the 2025 estimated tax forms and to notify those affected by the change. Additional costs may be required based on the number of affected taxpayers.

The Administration looks forward to working with the Committee on the bill; representatives from MRS will be here for the Work Session to provide additional information and respond in detail to the Committee's questions.