Maryland Taxation of Individual Capital Gain Income

I. General

Generally, capital gain is the difference between the adjusted basis of the asset and the amount realized from its sale. The Internal Revenue Code ("IRC") distinguishes between long-term and short-term capital gains and losses. If the asset is held for more than one year before disposition, the capital gain or loss is long-term; if the capital asset is held for less than one year, the capital gain or loss is short-term.[1] "Net capital gain" means the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year.[2]

Until 2025, capital gains of individuals have been taxed in Maryland in the same manner and at the same rate as ordinary income. In 2025, the Maryland General Assembly enacted legislation that imposes an additional 2% tax on net capital gains included in Maryland adjusted gross income. The tax is imposed on individuals with federal adjusted gross income ("FAGI") in excess of $350,000,regardless of filing status.

A fiduciary with federal taxable income in excess of $350,000 is subject to the additional tax on net capital gain on undistributed capital gain income.[3] The additional tax on net capital gain also applies to capital gain income that an individual with FAGI in excess of $350,000 receives from a fiduciary or a pass-through entity ("PTE"). When a fiduciary distributes net capital gain income to a beneficiary, the capital gain income is subject to the additional 2% tax if the beneficiary's FAGI is over $350,000. When a PTE distributes net capital gain income to an individual member whose FAGI is over $350,000, the capital gain income is subject to the additional 2% tax. The additional tax on net capital gain is not imposed on corporations.

The additional tax is imposed on net capital gain included in Maryland adjusted gross income. Maryland adjusted gross income equals FAGI, further adjusted by Maryland additions and subtractions. If the adjusted gross income of an individual or spouses filing a joint return exceeds $350,000 and includes any amount of net capital gain, as determined under the Internal Revenue Code, the State income tax for that individual or couple is the sum of: (1) the applicable income tax rate applied to Maryland taxable income, plus (2) an additional 2% tax on net capital gain included in the individual's Maryland adjusted gross income.[4]

II. Exceptions

Capital gains attributable to the sale or exchange of the following assets are not subject to the additional 2% tax:

A. Residential dwellings, including the land and any accessory dwelling unit associated with the residence, if the dwelling meets all the following requirements:

[1] See IRS Topic no. 409, Capital gains and losses: https://www.irs.gov/taxtopics/tc409
[2] IRC § 1222(11).
[3] The additional tax on net capital gain applies to "individuals" described in TG § 10-105(a)(1) and (2). Per TG § 10-101(g), "individual" means, unless expressly provided otherwise, a natural person or fiduciary.
[4] TG § 10-105(a)(3)(i).

1. the dwelling is the taxpayer's primary residence,
2. the dwelling is a single-family home, a townhome, a row home, a residential condominium unit, or a residential cooperative unit, and
3. the dwelling sold for less than $1,500,000;

B. Assets held in any of the following accounts:

1. cash or deferred arrangement plans under IRC §401(k),
2. tax-sheltered annuities or custodial accounts under IRC §403(b),
3. deferred compensation plans under IRC §457(b),
4. individual retirement accounts (IRAs) or individual retirement annuities under IRC §408,
5. Roth individual retirement accounts (Roth IRAs) under IRC §408A, or
6. defined contribution plans, defined benefit plans, or similar retirement savings plans;

C. Cattle, horses, or breeding livestock held for more than 12 months if, for the taxable year of the sale or exchange, more than 50% of the taxpayer's gross income for the taxable year, including income from the sale or exchange of capital assets, is from farming or ranching;

D. Land that is subject to a conservation, agricultural, or forest preservation easement or that will be subject to such an easement on the sale or exchange of the land;

E. Property used in a trade or business if the cost is deductible under IRC §179; and

F. Affordable housing owned by a nonprofit organization.[5,6]

III. Reporting Capital Gains Tax

A. Individuals

1. Estimated tax payments

   Individuals expecting to earn capital gain income must calculate and pay tax on Form 502D. Use the Payment Voucher Worksheet (PVW) to determine the amount of estimated tax to be paid.

   PTEs do not pay additional tax on capital gain income distributed to members. The tax is paid at the individual level (see Section IV). If an individual taxpayer expects to receive capital gain income from a PTE, the individual may need to make additional estimated payments to ensure they are not underpaid.

2. Reporting on the year-end return

   An individual with FAGI in excess of $350,000 who has received net capital gain income must report the income on Maryland Form 502CG and calculate the

[5] No part of the net earnings of a nonprofit may inure to the benefit of any private shareholder or individual.
[6] TG §10-105(a)(3)(ii).

additional tax. Report total net capital gain included in Maryland adjusted gross income, including capital gain income from a fiduciary or a PTE. Any portion of the net capital gain that was received from a fiduciary or a PTE is also reported. Report any amounts of capital gain from excepted assets, including amounts of capital gain income from excepted assets received from a fiduciary or a PTE, and subtract them to arrive at the net capital gain subject to additional tax.

For example, Jane McDonald, a Maryland resident, has FAGI in excess of $350,000 in tax year 2025. She is a member of E.I.O., LLC, a PTE. During tax year 2025, McDonald:

- earned net capital gain of $10,000 from the sale of horses by her Schedule C business reported on federal Form 4797;
- received $50,000 of net capital gain income, of which $32,000 is attributable to the sale of cattle reported on federal Form 4797, from E.I.O, LLC;
- sold her principal residence, which had a cost basis of $800,000, for $1.2 million, a $400,000 gain;
- sold her beach house, which had a cost basis of $500,000, for a sale price of $650,000, a $150,000 gain.

Farmer McDonald will report the capital gain on Form 502CG, as follows:

Part 2

Taxable Capital Gain Income Calculation

1.	Net capital gain income included in Maryland adjusted gross income (Line 1c of Form 502 or Line 7 Column 2 of Form 505. If less than or equal to 0 enter 0 and go to Line 9.) . . . . . . **1.**	610,000	00
1a.	Net capital gain income reported on Maryland Schedule(s) K-1. . . . . . **1a.** 50,000 00		
2.	Net capital gain income from the sale or exchange of your primary residence reported on federal Form 8949 or 6252 (see instructions). . . . . . **2.**	400,000	00
3.	Net capital gain income from the sale or exchange of assets held in a tax-advantaged retirement savings plan reported on federal Form 1040 Line 7 . . . . . . **3.**		00
4.	Net capital gain income from the sale or exchange of cattle, horses, or breeding livestock reported on federal Form 4797 (see instructions) . . . . . . **4.**	42,000	00
5.	Net capital gain income from the sale or exchange of land subject to a conservation, agricultural, or forest preservation easement reported on federal Form 8949 (see instructions) . . . . . . **5.**		00
6.	Net capital gain income from the sale or exchange of property used in a trade or business reported on federal Form(s) 4797, 8824, or 6252 (see instructions) . . . . . . **6.**		00
7.	Net capital gain income from the sale or exchange of affordable housing owned by a nonprofit organization reported on federal Form 1040 Line 7. . . . . . **7.**		00
8.	Net capital gain income not subject to additional tax (enter the sum of Lines 2 through 7) . . . . . . **8.**	442,000	00
9.	Net capital gain income subject to additional tax (subtract Line 8 from Line 1. Enter the amount here and on Line 20a of Form 502 or Line 31a of Form 505. If less than 0 enter 0.) . . . . . . **9.**	168,000	00

McDonald sums the income from excepted assets and subtracts that amount from the net capital gain included in Maryland AGI to arrive at the net capital gain subject to additional tax. She also enters the net capital gain subject to additional tax on the appropriate line on Form 502 or 505.

B. Fiduciaries

Fiduciaries may also earn capital gain income. For these taxpayers, capital gain is reported on federal Form 1041 Schedule D. The capital gain income flows from Schedule D to the taxpayer's Form 1041 where it is included in federal taxable income. The federal taxable income is then reported on Maryland Form 504 Fiduciary Income Tax Return and is included in the fiduciary's Maryland taxable net income and taxed at the applicable rate.

An estate or trust that is a member of a pass-through entity (PTE) and that has net capital gain income from the PTE must report its distributive or pro rata share of the PTE's net capital gain from Maryland Form 510/511 Schedule K-1.

An estate or trust that is a beneficiary of trust and received net capital gain income from the trust must report its distributive or pro rata share of the distributing trust's net capital gain from Maryland Form 504 Schedule K-1.

A taxpayer with federal taxable income in excess of $350,000, and that reports capital gain on the federal Form 1041 must complete Maryland Form 504CG Capital Gain Income to determine net capital gain income subject to the additional 2% tax. This amount is carried to Form 504, where the additional 2% tax is computed and included in Total Maryland Tax.

C. Pass-Through Entities

Capital gain income earned by a PTE is not subject to the additional tax on net capital gain at the entity level. However, the PTE must separately report income attributable to capital gain on Form 510/511 Schedule K-1 so that the PTE's members have the necessary information to report their share of the capital gains accurately on their own returns.

1. PTE tax does not include additional tax on net capital gain.

   A tax is imposed on each PTE.[7] A PTE must pay the tax on the distributive or pro rata shares of the nonresident individual and nonresident entity members. A PTE may elect to pay the tax on the distributive or pro rata shares of resident individual and resident entity members.[8]

   The PTE tax rate on resident and nonresident individual shares is equal to the lowest county tax rate plus the highest marginal State income tax rate.[9,10] For resident and nonresident entities, the rate is equal to the corporate tax rate.[11,12] This rate is applied to the sum of each member's share of the PTE's taxable income. PTEs provide each member with a statement showing the amount of tax paid by the PTE on the member's distributive or pro rata share of the PTE's taxable income on a Maryland Form 510/511 Schedule K-1, Maryland PTE Member's Information.

   For an individual member with net capital gain, the gain will be included on the individual's federal tax return as part of the FAGI (see Section III). If the member's FAGI exceeds $350,000, the gain will incur the additional tax on net capital gain. However, because the PTE income tax rate is statutory, and does not include the

[7] TG § 10-102.1(b)(1).
[8] TG § 10-102.1(b)(2).
[9] TG § 10-102.1(d)(1)(i), (d)(2)(i).
[10] For 2025, 8.75%.
[11] TG § 10-102.1(d)(1)(ii), (d)(2)(ii).
[12] For 2025, 8.25%.

additional tax on net capital gain income, PTEs are not required to calculate and remit any additional tax on net capital gain income included in members' distributive or pro rata shares. The member credit for taxes paid by the PTE is equal to the members' proportionate share of the tax paid by the PTE.[13] To the extent the PTE is overpaid, the overpayment is refunded to the PTE, or applied to the subsequent year's estimated tax payments.

Note: If an individual member of a PTE expects to receive PTE income attributable to capital gain, the member should calculate and make estimated payments to avoid being underpaid.

2. PTE reporting capital gain income

   PTEs must report the amount of capital gain income included in a member's distributive or pro rata share on the 510/511 Schedule K-1. Complete section H in full, listing the total capital gain income distributed to the member, as well as any income from the sale of excepted assets.

IV. Sale of real property by a nonresident

A. Withholding payment

Unless an exemption applies, proceeds from the sale of real property by a nonresident are subject to mandatory withholding. The withholding rate is set by statute and does not include the additional tax on net capital gain income.

If a nonresident selling real property expects the gain on the sale to be subject to the additional tax on net capital gain, they should make an additional estimated tax payment to avoid being underpaid.

B. Request for tentative refund

A nonresident who has sold real property and received proceeds from which estimated tax was withheld may apply for a tentative refund no earlier than 60 days after the deed is filed, and no later than December 1 of the year of the sale. The nonresident may receive a full or partial tentative refund if they provide documentation that the proceeds will not be subject to tax or will be subject to less tax than was withheld. The nonresident is still required to file a year-end return reporting the taxable gain and any other Maryland-sourced income.

So that the Comptroller can retain the correct amount of tax, and so that a nonresident is not underpaid at the time of the year-end filing, a nonresident who sells property for more than $1.5 million is not eligible for a tentative refund. They must file a year-end return to report the gain and request a refund or pay any additional tax owed.

V. IRC §1031 Exchange (Like-Kind Exchange)

A. Definition

An IRC §1031 exchange is an exchange of real property held for productive use in a trade or business or for investment solely for real property of a like kind to be held either for productive use in a trade or business or for investment, and in which, per the statute, no gain or loss is

[13] TG § 10-102.1(e).

recognized at that time.[14] IRC §1031 provides that the realized gain is deferred until the property received in the exchange is disposed of in a subsequent taxable transaction.

B. Maryland treatment of capital gains involving IRC §1031

Because the determination of Maryland adjusted gross income begins with FAGI, if the gain from a transaction is not included in the FAGI then it is not included in Maryland adjusted gross income.

Legal Division
P. O. Box 1829, Annapolis, Maryland 21404-1829
Telephone**: 410-260-7326**
www.marylandcomptroller.gov
For the deaf or hard of hearing: call via Maryland Relay at 711 in Maryland
or 1-800-735-2258

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[14] IRC § 1031, as effective for taxable years beginning on or after January 1, 2018. Prior to that date, deferral under §1031 was not limited to real property.