



AMERICAN COUNCIL FOR CAPITAL FORMATION

# Special Report

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## State Individual Capital Gains Tax Rates

**Table 1: States with No Individual Capital Gains Tax**

|               |
|---------------|
| Alaska        |
| Florida       |
| Nevada        |
| New Hampshire |
| South Dakota  |
| Tennessee     |
| Texas         |
| Washington    |
| Wyoming       |

Capital gains tax rates have become part of the policy debate about how to get the U.S. economy growing again. Some policymakers advocate reducing the top individual capital gains tax rate (now 15 percent) with the view that lower rates will encourage stock purchases and add stability to the U.S. financial sector. Other policymakers advocate raising the top individual capital gains tax rate to 20 percent next year in order to pay for individual income tax cuts or other programs. In addition, the current top Federal rate is set to expire on December 31, 2010, after which the top rate increases to 20%.

As Americans face the possibility of a higher Federal top capital gains tax rate, it may be helpful to examine the ramifications of such a policy shift. Raising the top Federal rate would exacerbate the combined Federal and State tax burden on the sale of capital assets already faced by taxpayers in most states. To highlight the current total tax bite faced by individual investors, the American Council for Capital Formation commissioned the internationally recognized accounting firm, Ernst & Young LLP, to compare the tax treatment of capital gains in the 50 states.

**Table 2: States with Highest Rates for Individual Capital Gains Taxes\***

|                |       |
|----------------|-------|
| California     | 25.3% |
| Oregon         | 24.0% |
| Iowa           | 24.0% |
| New Jersey     | 24.0% |
| DC             | 23.5% |
| Maine          | 23.5% |
| Minnesota      | 22.9% |
| Idaho          | 22.8% |
| North Carolina | 22.8% |
| Hawaii         | 22.3% |

\* Includes top Federal marginal capital gains rate of 15%.

As the new Ernst & Young report shows, investors face State-level individual capital gains taxes in forty-one States. According to the survey, the average top individual State capital gains tax rate on corporate equities was 5.8 percent in 2008. Combined with the federal capital gains tax rate, these State capital gains tax rates substantially increase the difference between what an investment yields and what an individual investor actually receives (known as the “tax wedge”). The higher the tax wedge, the fewer the number of investments that will meet the “hurdle rate” resulting in fewer investments being undertaken. State capital gains taxes, combined with the Federal tax, are therefore a direct impediment to entrepreneurship and consequently to economic growth.

As shown in **Table 1**, 9 States, including Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming, do not have a State capital gains tax rate.

**Table 2** shows the 10 States with highest combined Federal and State capital gains tax rate for individuals. California leads the group with a 25.3% rate. When the federal rate reverts to 20% in 2011, the top Federal and State capital gains tax rate in California will reach 30%. **Table 3** (on reverse) gives details on the maximum combined Federal/State capital gains tax rates on corporate equities for individuals in all 50 states.

**Table 3: Maximum State and Combined Federal/State Capital Gains Tax Rates on Corporate Equities for Individuals in 50 States and DC, 2008**

|                | Top Individual Statutory Income Tax Rate | Top Individual State Long-Term Capital Gains Tax Rate on Corporate Equities | Top Individual Combined Federal and State Long-Term Capital Gains Tax Rates on Corporate Equities <sup>1/</sup> | Individual Long-Term Holding Period for State Tax | Additional Details  |
|----------------|--|---|---|---|---|
| Alabama        | 5%                                       | 5%  | 20.0%   | N/A   |   |
| Alaska         | No Income Tax                            | No Income Tax   | 15.0%   | N/A   |   |
| Arizona        | 4.54%                                    | 4.54%   | 19.5%   | N/A   |   |
| Arkansas       | 7%                                       | 4.9%  | 19.9%   | 1 year  | 30% of net long-term capital gains are excluded.  |
| California     | 10.3%                                    | 10.3%   | 25.3%   | N/A   | A mental health tax of 1% applies to taxable income greater than \$1 billion.   |
| Colorado       | 4.63%                                    | 4.63%   | 19.6%   | N/A   |   |
| Connecticut    | 5%                                       | 5%  | 20.0%   | N/A   |   |
| Delaware       | 5.95%                                    | 5.95%   | 21.0%   | N/A   |   |
| DC             | 8.5%                                     | 8.5%  | 23.5%   | N/A   |   |
| Florida        | No Income Tax                            | No Income Tax   | 15.0%   | N/A   |   |
| Georgia        | 6%                                       | 6%  | 21.0%   | N/A   |   |
| Hawaii         | 8.25%                                    | 7.25%   | 22.3%   | 1 year  |   |
| Idaho          | 7.8%                                     | 7.8%  | 22.8%   | N/A   |   |
| Illinois       | 3%                                       | 3%  | 18.0%   | N/A   |   |
| Indiana        | 3.4%                                     | 3.4%  | 18.4%   | N/A   | Indianapolis (Marion county) taxes capital gains at 1.65%.  |
| Iowa           | 8.98%                                    | 8.98%   | 24.0%   | N/A   |   |
| Kansas         | 6.45%                                    | 6.45%   | 21.5%   | N/A   |   |
| Kentucky       | 6%                                       | 6%  | 21.0%   | N/A   |   |
| Louisiana      | 6%                                       | 6%  | 21.0%   | N/A   |   |
| Maine          | 8.5%                                     | 8.5%  | 23.5%   | N/A   |   |
| Maryland       | 5.5%                                     | 5.5%  | 20.5%   | N/A   | Some localities tax capital gains: the top local capital gains tax is 3.2% (2.83% in Baltimore city).   |
| Massachusetts  | 5.3%                                     | 5.3%  | 20.3%   | 1 year  | Net long-term capital gains on collectibles and pre-1996 installment sales are taxed at 12%.  |
| Michigan       | 4.35%                                    | 4.35%   | 19.4%   | N/A   | The city of Detroit taxes capital gains at a rate of 2.5%. The state allows a partial credit for city income taxes paid.  |
| Minnesota      | 7.85%                                    | 7.85%   | 22.9%   | N/A   |   |
| Mississippi    | 5%                                       | 5%  | 20.0%   | N/A   |   |
| Missouri       | 6%                                       | 6%  | 21.0%   | N/A   |   |
| Montana        | 6.9%                                     | 4.9%  | 19.9%   | 1 year  | Tax credit against income tax in an amount equal to 2% of capital gains, limited to taxpayer's income tax liability.  |
| Nebraska       | 6.84%                                    | 6.84%   | 21.8%   | N/A   | Once-in-a-lifetime exclusion for sale of certain stock.   |
| Nevada         | No Income Tax                            | No Income Tax   | 15.0%   | N/A   |   |
| New Hampshire  | No Income Tax                            | No Income Tax   | 15.0%   | N/A   | Tax on interest and dividends only (5%).  |
| New Jersey     | 8.97%                                    | 8.97%   | 24.0%   | N/A   |   |
| New Mexico     | 5.3%                                     | 2.65%   | 17.7%   | 1 year  | Up to 50% of net capital gains, or \$1,000 (whichever is greater) are deductible from state income taxation.  |
| New York       | 6.85%                                    | 6.85%   | 21.9%   | N/A   | Two cities tax capital gains: New York City (3.648%) and Yonkers (10%).   |
| North Carolina | 7.75%                                    | 7.75%   | 22.8%   | N/A   |   |
| North Dakota   | 5.54%                                    | 3.88%   | 18.9%   | 1 year  | 30% of net long-term capital gains are excluded.  |
| Ohio           | 6.24%                                    | 6.24%   | 21.2%   | N/A   |   |
| Oklahoma       | 5.5%                                     | 5.5%  | 20.5%   | N/A   | Net capital gains from sales of stocks or ownership interest in a company headquartered in Oklahoma are excluded; others are subject to ordinary taxation.                                    |
| Oregon         | 9%                                       | 9%  | 24.0%   | N/A   | Up to \$4,500 of federal income taxes deductible from state income taxation.  |
| Pennsylvania   | 3.07%                                    | 3.07%   | 18.1%   | N/A   | No capital net losses can be applied to other income, and losses must be applied currently.   |
| Rhode Island   | 9.99%                                    | 1.67%   | 16.7%   | 5 years   | Optional ordinary income flat rate of 7.5%. Capital gains from assets with holding period between 1 and 5 years are taxed at 5%. Other capital gains are subject to ordinary income taxation. |
| South Carolina | 7%                                       | 3.92%   | 18.9%   | 1 year  | 44% of net long-term capital gains are excluded.  |
| South Dakota   | No Income Tax                            | No Income Tax   | 15.0%   | N/A   |   |
| Tennessee      | No Income Tax                            | No Income Tax   | 15.0%   | N/A   | Capital gains distributions from mutual funds only are taxed.   |
| Texas          | No Income Tax                            | No Income Tax   | 15.0%   | N/A   |   |
| Utah           | 5%                                       | 5%  | 20.0%   | N/A   |   |
| Vermont        | 9.5%                                     | 5.7%  | 20.7%   | 1 year  | 40% of net long-term capital gains are excluded.  |
| Virginia       | 5.75%                                    | 5.75%   | 20.8%   | N/A   |   |
| Washington     | No Income Tax                            | No Income Tax   | 15.0%   | N/A   |   |
| West Virginia  | 6.5%                                     | 6.5%  | 21.5%   | N/A   |   |
| Wisconsin      | 6.75%                                    | 2.7%  | 17.7%   | 1 year  | 60% of net long-term capital gains are excluded.  |
| Wyoming        | No Income Tax                            | No Income Tax   | 15.0%   | N/A   |   |

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<sup>1/</sup> Federal maximum long-term capital gains tax rate of 15% in 2008. The combined federal and state tax rate is for non-itemizers, or before deductions of state income taxes from federal taxable income for itemizers, and before deduction of federal income taxes from state taxable income in certain states.