Maryland Increases Service, Individual, and Capital Gains Taxes

By Leticia Skrabut

Maryland's "Budget Reconciliation and Financing Act of 2025" (H.B. 352) was passed by both the Maryland Senate and the House of Delegates on April 7, 2025. On May 20, 2025, Maryland Governor Wes Moore signed the bill expanding "taxable services" as described under the North American Industry Classification System (NAICS) and enacting a 3 percent sales tax.

The bill also increases individual income tax rates to 6.50 percent for those making taxable income in excess of $250,000, allowing for a new 3.30 percent county income tax rate ceiling, and imposes an additional 2 percent tax on the amount of net capital gain.

NAICS 3 Percent Sales tax

The bill expands the scope of "taxable services" as described under NAICS classifications, implementing a 3 percent sales and use tax on data or information technology services described under NAICS Sectors 518 (Data Processing, Hosting, and Related Services), 519 (News syndicates, Libraries, Archives, Exclusive Internet publishing and/or broadcasting, Web search portals, and Other information services), or 5415 (Computer System Designs and Related Services); or system or application software publishing services under NAIC Sector 5132.

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The legislation includes a presumption that the taxable service of the NAICS Sectors mentioned above will be made in the state in which the customer's tax address is located. Although the legislation specifies a 3 percent taxable rate, it also states that if a different rate could be applied to a sale or use of tangible personal property, a digital code, a digital product, or a taxable service, the higher rate will be applied to the sale. However, this sales and use tax will not be applied to a sale of cloud computing to a qualified cybersecurity business. Additionally, the tax exemption applies to a qualified company located in an emerging technology development area when the exemption is directly tied to the company's work. Separately, a company situated in an emerging technology development area also qualifies for the exemption when it is granted based solely on the company's location.

Under the bill, an emerging technology development area is defined as the University of Maryland's Discovery District in Prince George's County. A qualified company refers to an entity that contracts with the University of Maryland's Applied Research Laboratory for Intelligence and Security to develop systems and technologies that advance quantum computing.

This 3 percent sales tax may apply to many business-to-business ("B2B") transactions and may impact sellers with Maryland-sources sales and purchasers that have in-state use of the Maryland services.

Maryland currently has a base sales tax of 6 percent. The 6 percent sales tax will remain unchanged, but certain B2B IT-related services (currently exempt from the 6 percent sales and use tax) will now be taxed at 3 percent, unless a higher applicable rate takes precedence. Meaning some business transactions could still be taxed at 6 percent rather than 3 percent.

Increase of Individual Tax Rate to 6.50 Percent

Through tax year 2024, Maryland's graduated personal income tax rate increases to a maximum of 5.75 percent for income exceeding $250,000 for single filers, or $300,000 if filing jointly. The new legislation retains this, but has added new tax rates for incomes in excess of $500,000 and $1,000,000.

The new tax rates for single filers are as follows:

- 5.75 percent of taxable income in excess of $250,000 (excess of $300,000 for spouses filing jointly);
- 6.25 percent of taxable income in excess of $500,000 (excess of $600,000 for spouses filing jointly); and
- 6.50 percent of taxable income in excess of $1,000,000 (excess of $1,200,000 for spouses filing jointly).

Individuals whose federal adjusted gross income exceeds the applicable amount ($100,000 for married individuals filing separately; and $200,000 for all other filers), the itemized deductions allowable for a taxable year has been reduced by 7.5 percent. Meaning that high-income earning individuals in Maryland will now see fewer deductions, leading to higher state tax liabilities.

Additionally, the new legislation has raised the allowable county income tax from 3.20 percent to 3.30 percent. Which gives the power to each county to increase its county income tax rate.

Additional 2 Percent tax on net capital gain

Previously, if an individual's adjusted gross income included any amount of net capital gain they were subject to an additional 1 percent of state income tax on the amount of net capital gain included in their income. Now, they will be subject to an additional 2 percent, however this will only be applicable to individuals with a federal adjusted gross income in excess of $350,000.

However, the following will not be subject to the 2 percent tax on net capital gain:

- Residential dwellings sold for less than $1,500,000;
- Assets held in cash, custodial accounts, deferred compensation plans, retirement accounts, and other financial holdings and property types;
- Cattle, horses, or breeding livestock held for more than 12 months;
- Land subject to a conservation;
- Property used in a trade or business; and
- Affordable housing.

The recent tax increases in Maryland will result in higher income tax rates for high-income earners. As a result, affected taxpayers may want to explore strategic tax planning options to mitigate the impact of these changes.

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