SENATE BILL REPORT
ESSB 5096

As Amended by House, April 21, 2021

Title: An act relating to enacting an excise tax on gains from the sale or exchange of certain capital assets.

Brief Description: Investing in Washington families and creating a more progressive tax system in Washington by enacting an excise tax on the sale or exchange of certain capital assets.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Robinson, Hunt, Nguyen and Wilson, C.; by request of Office of Financial Management).

Brief History:

Committee Activity: Ways & Means: 1/14/21, 2/16/21 [DPS, DNP, w/oRec].

Floor Activity: Passed Senate: 3/6/21, 25-24.
Passed House: 4/21/21, 53-45; 4/21/21, 52-46.

Brief Summary of Engrossed First Substitute Bill

- Imposes a 7.0 percent capital gains tax beginning January 1, 2022.

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 5096 be substituted therefor, and the substitute bill do pass.
Signed by Senators Rolfes, Chair; Frockt, Vice Chair, Capital; Robinson, Vice Chair, Operating & Revenue; Carlyle, Conway, Darneille, Dhingra, Hasegawa, Hunt, Keiser, Liias, Pedersen and Wellman.

Minority Report: Do not pass.
Signed by Senators Wilson, L., Ranking Member; Brown, Assistant Ranking Member, Operating; Honeyford, Assistant Ranking Member, Capital; Schoesler, Assistant Ranking Member, Capital; Gildon, Mullet, Muzzall, Rivers, Wagoner and Warnick.

Minority Report: That it be referred without recommendation.
Signed by Senator Van De Wege.

Staff: Jeffrey Mitchell (786-7438)

Background: A capital gains tax (CGT) is a tax on the profit realized on the sale of non-inventory assets purchased at a lower price than the sales price. Common examples are capital gains realized from the sale of stocks, bonds, mutual funds, boats, and real estate. Under the federal tax code, individuals and corporations pay income tax on the net total of all their capital gains just as they do on other sorts of income. For individuals, the amount of federal CGT depends on the tax bracket of the individual and the amount of time the capital asset was held before being sold. Short-term capital gains are taxed at the individual's ordinary income tax rate, and are defined as capital assets held for a year or less before being sold. Currently, long-term capital gains are generally taxed at a preferential rate in comparison to ordinary income for federal income tax purposes. In 2021, the top marginal rate on ordinary income is 37 percent compared with a top marginal rate of 20 percent for long-term capital gains. In addition to the federal tax, capital gains are often subject to state income taxes. Most states do not have separate capital gains tax rates. Instead, most states tax capital gains as ordinary income subject to the state's income tax rates.

Summary of Engrossed First Substitute Bill: Beginning January 1, 2022, an annual state net CGT is imposed on the sale or other voluntary exchange of long-term capital assets by individuals. The tax rate is 7.0 percent. Generally, the tax rate is applied to the capital gains amount reported on the individual's federal income tax return. For resident individuals, all capital gains from the sale or exchange of intangible personal property, such as stock, are allocated to Washington. Capital gains from real estate transactions are allocated to Washington if the real property is located in Washington. Generally, capital gains from the sale or exchange of tangible personal property are allocated to Washington if the property was located in Washington at the time of the transaction.

All taxpayers must file with the state Department of Revenue (DOR), a CGT return for each taxable year; however, a person with no tax liability is not required to file a tax return. The due date of the state CGT return is the due date for the federal income tax return, unless otherwise required by DOR. The first state CGT returns are due in 2023.

The first $250,000 of capital gains are excluded from the state CGT. Beginning with taxes due and payable in 2024, the $250,000 amount is adjusted annually by inflation.

Sales or exchanges of some capital assets are explicitly excluded from the state CGT, including:
- all real estate—land and structures;
- controlling interests in a business entity for the portion of the sale or exchange directly attributable to the entity's interest in real property if the sale or exchange was

subject to real estate excise tax;
- assets held in a retirement account;
- assets transferred as part of a condemnation proceeding;
- livestock related to farming or ranching;
- certain types of property used in a trade or business such as machinery and equipment that have been immediately expensed;
- capital assets acquired and used only for purposes of a trade or business of a sole proprietorship;
- timber and timberlands; and
- goodwill received from the sale of a franchised auto dealership.

A deduction is provided for the sale of substantially all of a qualified family-owned small businesses. A qualified family-owned business is a business where:
- the owner of the business held a qualifying interest for at least eight years immediately before the sale or transfer of the business;
- the owner of the business or their family member materially participated in operating the business for at least five of the last eight years; and
- the business had worldwide gross revenue of $10 million or less in the 12-month period preceding the sale or transfer of the business—beginning with taxes due and payable in 2024, the $10 million amount is adjusted annually by inflation.

Revenues from the tax, and any associated interest and penalties, are distributed as follows: The first $350 million of state CGT revenues received each year are deposited into the state Education Legacy Trust Account; the next $100 million is deposited into the state general fund; and the remainder is deposited into a new Taxpayer Fairness Account. Beginning with taxes due and payable in 2024, the $350 and $100 million amounts are adjusted by inflation.

To avoid taxing the same sale or exchange under both the business and occupation tax (B&O) and capital gains tax, a credit is allowed against the B&O tax for any capital gains tax owed on the sale or exchange of the capital asset.

Appropriation: None.

Fiscal Note: Available.

Creates Committee/Commission/Task Force that includes Legislative members: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony on Original Bill: *The committee recommended a different version of the bill than what was heard.* PRO: This bill is a way to help balance the regressive tax structure in Washington. This bill is a key piece to support the proposed expenditures in the Governor's budget. Due to the lasting effects of institutional racism, capital assets remain concentrated among a small group of very wealthy and almost exclusively white households. Taxing these households and investing the revenue in education, healthcare, childcare, and other community needs would begin to address the widening wealth gap. Passing this bill would stimulate the economy and create thousands of jobs. Washington is one of only nine states that does not tax capital gains. If you are worried about the wealthy fleeing our state, there are not too many other places they can go where they would not be subject to a similar tax. Our tax code is upside down. People with the lowest incomes pay more in state taxes than the highest income households, which exacerbates the racial wealth gap. This is a serious social justice issue. The wealthy can and should pay their fair share. The argument that a capital gains tax is bad for business rings pretty hollow when many of the states ranked higher than Washington in terms of business climate have a capital gains tax. Fewer than 60,000 taxpayers would pay the tax. Please look at funding the working families tax exemption program. Progressive taxation is a key priority. This is a fairer way for the state to pay its bills. Exemptions and thresholds will encourage taxpayers to game the system. A broader base and lower rate is preferable. The state should have a tax structure that generates adequate revenue and is fair and racially equitable. Our tax structure is the most regressive in the nation. Fifty-nine percent of Washingtonians surveyed supported a capital gains tax to help pay for education. It is time that low-income people stop footing the bill for public services. This state is a tax shelter while so many others do not have a cent in their bank accounts. This tax will help create jobs, get workers and businesses back online, and reinvest in needed supports and services. Washington continues to lag well behind the rest of the nation in funding services for people with development disabilities. The development disabilities community was already in crisis before the pandemic struck. The revenues generated in this bill will help prioritize these services. A more equitable tax structure will help make our state a place where we can live, work, and play with a sense of pulling together. This bill will allow Washington to tap a small portion of wealth to finance critical investments. This is a just and fair revenue package that will make our state better and improve the regressive nature of our state's tax structure. Societies that are more unequal have lower life expectancies than societies that are more equal. This bill will help correct our unfair and unhealthy and regressive tax structure.

CON: A capital gains tax is not an excise tax, it is an income tax. A capital gains tax is an unconstitutional income tax. A capital gains tax is very volatile. California amended its constitution to take it off the balance sheet so it would stop wrecking their budget process. A recession is a bad time to be asking for more money, especially when state tax revenues are up over the past three years. The inclusion of the emergency clause is an abuse of the people's right to referendum. This bill is bad policy, bad economics, and bad governance. This is a time when the focus should be on economic recovery and removing obstacles, not increasing taxes. At the very least, the Legislature should do no harm. We need economic recovery right now, not tax increases. The voters have rejected an income tax ten times. The last time was in 2010 when 65 percent of the voters rejected the proposal. The voters understand that once this Pandora's box is open where an income tax is imposed on some of us, it will soon be imposed on all of us. This bill will negatively impact small and large businesses alike by diminishing their owners' financial risk and sacrifice personal talent if they are fortunate enough to benefit from their efforts. This is the wrong direction for our state to go in. For small business owners, their business's value is their retirement. This bill treats different structures differently. Sole proprietorships have an exemption but other small business types such as partnerships and limited liability companies do not have an exemption. There is an inconsistency with federal law with respect to loss carry forwards. Paying a 9 percent tax when we sell our business to retire will devastate us. Capital gains are not a consistent source of income. This tax is illegal under our state constitution. A capital gains tax will discourage investment in farms and businesses that grow our food and grow our economy. Recently, the state real estate excise tax (REET) has almost doubled. It is now the highest tax rate in the country. Adding a capital gains tax on top of the REET will increase the burden substantially and make it difficult for our business to continue to produce much needed affordable housing. Having such a low threshold is unfair. A lot of business owners lost a substantial amount of business during the pandemic and are trying to recoup some of the losses on the stock market. It is not the right time to impose a new tax when so many of our small businesses are still shut down. The sale of a small business forms the backbone of many retirements. A 9 percent tax will carve out a substantial amount right off the top. Imposing a tax on housing of four or more units will be detrimental. Because of the recent substantial increases to the REET, real estate should be completely exempted from this tax. When it comes to new taxes, the voters should decide. It is a fallacy to think this bill would only tax the wealthy—it is going to impact low- and moderate-income people as well. For example, a lot of people own a little bit of rental property. When they sell it, they will owe a Washington capital gains tax. This is effectively a tax on creativity, innovation, job creation, and risk taking. It penalizes small business owners who grow their businesses and become successful. A capital gains tax is an inconsistent tax and an unfair tax. The construction industry is capital intensive. A capital gains tax makes this industry less economically efficient.

OTHER: Capital gains have extreme volatility and this would be the seventh highest tax rate in the country. The thresholds are so low that it will capture many retirees. It will also impact those who invested while they worked and are now selling to retire. Furthermore, the thresholds are not tied to inflation. We are not aware of another state not allowing loss carry forwards. This tax will apply to real estate, which is already subject to a number of other taxes creating a layering effect. This bill deviates from the federal capital gains tax. Despite having one of the best economies in the country, Washington is ranked 39th in community-based spending on people with developmental disabilities so we are encouraged by the additional revenue this bill would generate.

Persons Testifying: PRO: Senator June Robinson, Prime Sponsor; Jacob Vigdor, University of Washington; Darrell Johnson, NA; Courtney Williams, Community Employment Alliance; Cynthia Stewart, League of Women Voters of Washington; Scott Merriman, Office of Financial Management; Jack Brumbaugh, Department of Revenue; Seth Dawson, Community Employment Alliance; Julia Buck; Matthew Lang, Seattle Transit Riders Union; Summer Stinson, Economic Opportunity Insitute; Andrew

Villeneuve, Northwest Progressive Institute; Stephen Gillett; Martha Burke; Nina Crocker; Emily Murphy, NARAL Pro-Choice Washington; Retired Public Employees Council; Children's Alliance; Todd Foster, The Foster Group, Inc.; Robert Cruickshank, Washington's Paramount Duty; Katrina Simmons, Retired Public Employees Council; Aaron Czyzewski, Food Lifeline; Claudia Balducci, King County Council; Brittany Williams, Home Care Aide/SEIU 775 Caregiver; Andy Nicholas, Washington State Budget & Policy Center; Sonya Campion, Campion Foundation; Zak Nelson, SEIU 925; Dr. Mark Vossler, Washington Physicians for Social Responsibility; Jennifer Bereskin, RAP Resident Action Project Steering Committee & WLIHA Board Member; Clifford Cawthon, MLK County Working Families Party.

CON: Jason Mercier, Washington Policy Center; Ryan Ottele; Tommy Gantz, Association of Washington Business; Tim Eyman, Permanent Offense; Kenneth Moninski; Mark Johnson, Washington Retail Association; Jeff Pack, Me; Lois Cook, America's Phone Guys; Bill Stauffacher, Independent Insurance Agents & Brokers of Washington; Building Industry Association of Washington; Wayne Lunday, National Association of Insurance and Financial Advisors; Greg Seifert, Washington Association of Health Underwriters; Steve Miller, Pacific Propane Gas Association; Matthew Nichols; Patrick Connor, NFIB; Kevin Wallace, Wallace Properties, Inc.; Don Arsenault, CCIM, Washington Self-Storage Association & CCIM Institute; Sharon Lewis; Ashley Cooper; Jack Field, Washington Cattle Feeders Association; Tracy Doriot; Jim Lusk, Retirement Nationwide, Inc.; Christophe Allen, Acme Fuel Company; Tom Davis, Washington Farm Bureau; Tom Hatcher; Richard Beeson; Debra Manjarrez; Steve Edwards; Michael Eisenberg; Gary Smith, Independent Business Association; Chester Baldwin, Washington Business Properties Association; BOMA; Rental Housing Association; Manufactured Housing Communities; ICSC; Kenneth Rosenkranz; Brian Hess; Jerry VanderWood, AGC of Washington; Jake Jacobson, Osborne Construction and AGC; Adrian Bradford, COR Cellars & Vineyards; Mark Streuli, Washington Cattlemens Association; Ted DeVol; Sharon Hanek; Paul Schmidt; Russell Millard, Park Preservations LLC; Dan Piantanida, GP Realty Finance, Inc; Codi Winans; Jeffrey Slotnick, Setracon Inc.; Aaron Lang; Pamela Manley; Gary Wray; Tad Sommerville; Dan Jennings; Susan Gonzales; Daniel Schiffelbein.

OTHER: Adrienne Stuart, Developmental Disabilities Council; Jared Walczak, Tax Foundation; Moriah Banasick, Washington State Society of Certified Public Accountants; Joseph Bishop-Henchman, National Taxpayers Union Foundation; Joseph Carroll.

Persons Signed In To Testify But Not Testifying: No one.

EFFECT OF HOUSE AMENDMENT(S):

- Deposits all proceeds from the tax, and any associated interest and penalties, into the Education Legacy Trust Account.
- Exempts sales or exchanges of interests in a privately held entity to the extent that any long-term capital gain or loss is directly attributable to the real estate owned directly by the entity.

- Provides an exemption for commercial fishing privileges.
- Updates the intent section.
- Reorders some sections and adds section captions.
- Specifies that the tax imposed is necessary for the support of state government and its existing institutions.
- Clarifies the application of a standard deduction to individuals, spouses, and registered domestic partners.
- Amends the Education Legacy Trust Account to permanently allow funds to be used for early learning and child care programs.
- Reduces the number of years a taxpayer must own the qualified family-owned small business from eight years to five years in order to qualify for the deduction.
- Removes the authorization for DOR to require the filing of informational returns.
- Increases the look-back period to meet the material participation requirements for the qualified family-owned small business deduction from eight years to ten years.