SENATE BILL REPORT
SB 5096

As of January 13, 2021

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

Brief Description: Concerning an excise tax on gains from the sale or exchange of certain capital assets.

Sponsors: Senators Robinson, Wilson, C., Hunt and Nguyen; by request of Office of Financial Management.

Brief History:
Committee Activity: Ways & Means: 1/14/21.

Brief Summary of Bill

- Imposes a 9.0 percent capital gains tax beginning January 1, 2022.

SENATE COMMITTEE ON WAYS & MEANS

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

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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 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 9.0 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.

For individuals filing single returns, the first $25,000 in long-term capital gains is excluded from the state CGT. For individuals filing joint returns, the first $50,000 is excluded from the state CGT.

Sales or exchanges of some capital assets are explicitly excluded from the state CGT, including:

- residential dwellings along with the land upon which the dwelling is located;
- assets held in a retirement account;
- assets transferred as part of a condemnation proceeding;
- livestock related to farming or ranching;
- agricultural land that meets certain requirements;
- 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; and
- timber and timberlands.

All state CGT revenues are deposited into the state general fund.

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.

DOR is authorized to disregard certain transactions involving the use of the capital gains tax exemption for assets sold or exchanged by a sole proprietorship where there is sufficient evidence suggesting the business arrangement was undertaken primarily to avoid capital gains tax. Disregarded transactions are subject to a 35 percent penalty in addition to other interest and penalties that may be owed.

A legislative directive to the courts is provided that requires ambiguous language to be construed in favor of application of the tax.

To aid in the administration and collection of the CGT, DOR is authorized to enter into reciprocal tax collection agreements with taxing officials in other states imposing state income taxes, stand-alone taxes on capital gains or interest and dividends, broad-based gross receipts taxes, or generally applicable sales and use taxes.

Appropriation: None.

Fiscal Note: Available.

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

Effective Date: The bill contains an emergency clause and takes effect immediately.