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**ENGROSSED SUBSTITUTE SENATE BILL 5096**

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**State of Washington 67th Legislature 2021 Regular Session**

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

AN ACT Relating to 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; adding a new section to chapter 82.04 RCW; adding a new chapter to Title 82 RCW; creating new sections; and prescribing penalties.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

**Part I**

**Capital Gains Tax**

NEW SECTION. **Sec.**  (1) The legislature recognizes that a tax system that is fair, balanced, and works for everyone is essential to help all Washingtonians grow and thrive. But Washington's tax system today is the most regressive in the nation because it asks those making the least to pay the most as a percentage of their income. Middle-income families in Washington pay two to four times more in taxes, as a percentage of household income, as compared to top earners in the state. Low-income Washingtonians pay at least six times more than do our wealthiest residents. To begin to rebalance the tax code, the legislature intends to enact an excise tax on the sale of certain capital assets.

(2) The excise tax on capital gains is a tax on the one-time, voluntary sale or exchange of a capital asset, not a tax on ownership of the asset itself. This excise tax is paid only by those individuals who engage in voluntary sales or exchanges of Washington capital assets, either directly or indirectly through their ownership interest in an entity that engages in voluntary sales or exchanges of Washington capital assets, and is measured by the realization of significant net gain on the aggregate of such transactions during the taxable year. In order to protect against further regressive impacts of the tax system, encourage the everyday investments that Washingtonians of all income levels strive for, and support our economy, this excise tax will not apply to capital gains realized by certain sales and transfers.

(3) To help meet the state's obligations to its people, the legislature dedicates the first $350,000,000 in revenue collected from this excise tax to the state's education legacy trust account. This funding is critically needed to provide support for education, especially early learning and child care, and to provide for the economic security of low-income households who are struggling to afford quality child care and preschool. Furthermore, the legislature finds that increasing taxes on the wealthiest residents is only one-half of the effort to rebalance the tax code. In an effort to both reduce the tax burden on those earning the least and to account for anticipated volatility in revenue collections from the capital gains excise tax, revenue received above base levels will be deposited into the taxpayer fairness account. Revenues deposited in this account will be used to offset existing tax burdens via policies such as funding of the working families' tax exemption.

NEW SECTION. **Sec.**  The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1) "Adjusted capital gain" means federal net long-term capital gain:

(a) Plus any amount of long-term capital loss from a sale or exchange that is exempt from the tax imposed in this chapter, to the extent such loss was included in calculating federal net long-term capital gain;

(b) Plus any amount of long-term capital loss from a sale or exchange that is not allocated to Washington under section 108 of this act, to the extent such loss was included in calculating federal net long-term capital gain;

(c) Plus any amount of loss carryforward from a sale or exchange that is not allocated to Washington under section 108 of this act, to the extent such loss was included in calculating federal net long-term capital gain;

(d) Less any amount of long-term capital gain from a sale or exchange that is not allocated to Washington under section 108 of this act, to the extent such gain was included in calculating federal net long-term capital gain; and

(e) Less any amount of long-term capital gain from a sale or exchange that is exempt from the tax imposed in this chapter, to the extent such gain was included in calculating federal net long-term capital gain.

(2) "Capital asset" has the same meaning as provided by Title 26 U.S.C. Sec. 1221 of the internal revenue code and also includes any other property if the sale or exchange of the property results in a gain that is treated as a long-term capital gain under Title 26 U.S.C. Sec. 1231 or any other provision of the internal revenue code.

(3) "Federal net long-term capital gain" means the net long-term capital gain reportable for federal income tax purposes determined as if Title 26 U.S.C. Secs. 55 through 59, 1400Z-1, and 1400Z-2 of the internal revenue code did not exist.

(4) "Individual" means a natural person.

(5) "Internal revenue code" means the United States internal revenue code of 1986, as amended, as of the effective date of this section, or such subsequent date as the department may provide by rule consistent with the purpose of this chapter.

(6) "Long-term capital asset" means a capital asset that is held for more than one year.

(7) "Long-term capital gain" means gain from the sale or exchange of a long-term capital asset.

(8) "Long-term capital loss" means a loss from the sale or exchange of a long-term capital asset.

(9) "Real estate" has the same meaning as in RCW 82.45.032, except that real estate does not include an individual's ownership interest or beneficial interest in an entity which itself owns an interest in real property located in this state for the purposes of this chapter.

(10)(a) "Resident" means an individual:

(i) Who is domiciled in this state during the taxable year, unless the individual (A) maintained no permanent place of abode in this state during the entire taxable year, (B) maintained a permanent place of abode outside of this state during the entire taxable year, and (C) spent in the aggregate not more than 30 days of the taxable year in this state; or

(ii) Who is not domiciled in this state during the taxable year, but maintained a place of abode and was physically present in this state for more than 183 days during the taxable year.

(b) For purposes of this subsection, "day" means a calendar day or any portion of a calendar day.

(c) An individual who is a resident under (a) of this subsection is a resident for that portion of a taxable year in which the individual was domiciled in this state or maintained a place of abode in this state.

(11) "Taxable year" means the taxpayer's taxable year as determined under the internal revenue code.

(12) "Taxpayer" means an individual subject to tax under this chapter.

(13) "Washington capital gains" means an individual's adjusted capital gain less $250,000, as adjusted annually under section 115 of this act, for each return filed under this chapter.

NEW SECTION. **Sec.**  (1) Beginning January 1, 2022, an excise tax is imposed on the sale or exchange of long-term capital assets. Only individuals are subject to payment of the tax, which equals seven percent multiplied by an individual's Washington capital gains.

(2) If an individual's Washington capital gains are less than zero for a taxable year, no tax is due under this section and no such amount is allowed as a carryover for use in the calculation of that individual's adjusted capital gain, as defined in section 102(1) of this act, for any taxable year. To the extent that a loss carryforward is included in the calculation of an individual's federal net long-term capital gain and that loss carryforward is directly attributable to losses from sales or exchanges allocated to this state under section 108 of this act, the loss carryforward is included in the calculation of that individual's adjusted capital gain for the purposes of this chapter. An individual may not include any losses carried back for federal income tax purposes in the calculation of that individual's adjusted capital gain for any taxable year.

(3)(a) The tax imposed in this section applies to the sale or exchange of long-term capital assets owned by the taxpayer, whether the taxpayer was the legal or beneficial owner of such assets at the time of the sale or exchange. The tax applies when the Washington capital gains are recognized by the taxpayer in accordance with this chapter.

(b) For purposes of this chapter:

(i) An individual is considered to be a beneficial owner of long-term capital assets held by an entity that is a pass-through or disregarded entity for federal tax purposes, such as a partnership, limited liability company, S corporation, or grantor trust, to the extent of the individual's ownership interest in the entity as reported for federal income tax purposes.

(ii) A nongrantor trust is deemed to be a grantor trust if the trust does not qualify as a grantor trust for federal tax purposes, and the grantor's transfer of assets to the trust is treated as an incomplete gift under Title 26 U.S.C. Sec. 2511 of the internal revenue code and its accompanying regulations. A grantor of such trust is considered the beneficial owner of the capital assets of the trust for purposes of the tax imposed in this section and must include any long-term capital gain or loss from the sale or exchange of a capital asset by the trust in the calculation of that individual's adjusted capital gain, if such gain or loss is allocated to this state under section 108 of this act.

NEW SECTION. **Sec.**  This chapter does not apply to the sale or exchange of:

(1) All real estate;

(2) A controlling interest in an entity only to the extent that any long-term capital gain or loss from such sale or exchange is directly attributable to the entity's interest in real property and the sale or exchange was subject to tax under chapter 82.45 RCW. The department is not bound by the parties' agreement as to the allocation of consideration or fair market value, if such allocation or fair market value does not reflect the fair market value of the real property. For purposes of this subsection (2), "controlling interest" has the same meaning as in RCW 82.45.033;

(3) Assets held under a retirement savings account under Title 26 U.S.C. Sec. 401(k) of the internal revenue code, a tax-sheltered annuity or custodial account described in Title 26 U.S.C. Sec. 403(b) of the internal revenue code, a deferred compensation plan under Title 26 U.S.C. Sec. 457(b) of the internal revenue code, an individual retirement account or individual retirement annuity described in Title 26 U.S.C. Sec. 408 of the internal revenue code, a Roth individual retirement account described in Title 26 U.S.C. Sec. 408A of the internal revenue code, an employee defined contribution program, an employee defined benefit plan, or a similar retirement savings vehicle;

(4) Assets pursuant to, or under imminent threat of, condemnation proceedings by the United States, the state or any of its political subdivisions, or a municipal corporation;

(5) Cattle, horses, or breeding livestock if for the taxable year of the sale or exchange, more than 50 percent of the taxpayer's gross income for the taxable year, including from the sale or exchange of capital assets, is from farming or ranching;

(6) Property depreciable under Title 26 U.S.C. Sec. 167(a)(1) of the internal revenue code, or that qualifies for expensing under Title 26 U.S.C. Sec. 179 of the internal revenue code;

(7) Timber, timberland, or the receipt of Washington capital gains as dividends and distributions from real estate investment trusts derived from gains from the sale or exchange of timber and timberland. "Timber" means forest trees, standing or down, on privately or publicly owned land, and includes Christmas trees and short-rotation hardwoods. The sale or exchange of timber includes the cutting or disposal of timber qualifying for capital gains treatment under Title 26 U.S.C. Sec. 631(a) or (b) of the internal revenue code; and

(8) Goodwill received from the sale of an auto dealership licensed under chapter 46.70 RCW whose activities are subject to chapter 46.96 RCW.

NEW SECTION. **Sec.**  The tax imposed under this chapter is in addition to any other taxes imposed by the state or any of its political subdivisions, or a municipal corporation, with respect to the same sale or exchange, including the taxes imposed in, or under the authority of, chapter 82.04, 82.08, 82.12, 82.14, 82.45, or 82.46 RCW.

NEW SECTION. **Sec.**  In computing tax, there may be deducted from the measure of tax amounts that the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States.

NEW SECTION. **Sec.**  (1) In computing tax under this chapter for a taxable year, a taxpayer may deduct from the measure of tax the amount of adjusted capital gain derived in the taxable year from the sale of substantially all of the fair market value of the assets of, or the transfer of substantially all of the taxpayer's interest in, a qualified family-owned small business, to the extent that such adjusted capital gain would otherwise be included in the taxpayer's Washington capital gains.

(2) For purposes of this section, the following definitions apply:

(a) "Assets" means real property and personal property, including tangible personal property and intangible property.

(b) "Family" means the same as "member of the family" in RCW 83.100.046.

(c)(i) "Materially participated" means an individual was involved in the operation of a business on a basis that is regular, continuous, and substantial.

(ii) The term "materially participated" must be interpreted consistently with the applicable treasury regulations for Title 26 U.S.C. Sec. 469 of the internal revenue code, to the extent that such interpretation does not conflict with any provision of this section.

(d) "Qualified family-owned small business" means a business:

(i) In which the taxpayer held a qualifying interest for at least eight years immediately preceding the sale or transfer described in subsection (1) of this section;

(ii) In which either the taxpayer or members of the taxpayer's family, or both, materially participated in operating the business for at least five of the eight years immediately preceding the sale or transfer described in subsection (1) of this section, unless such sale or transfer was to a qualified heir; and

(iii) That had worldwide gross revenue of $10,000,000 or less in the 12-month period immediately preceding the sale or transfer described in subsection (1) of this section. The worldwide gross revenue amount under this subsection (2)(d)(iii) shall be adjusted annually as provided in section 115 of this act.

(e) "Qualified heir" means a member of the taxpayer's family.

(f) "Qualifying interest" means:

(i) An interest as a proprietor in a business carried on as a sole proprietorship; or

(ii) An interest in a business if at least:

(A) Fifty percent of the business is owned, directly or indirectly, by any combination of the taxpayer or members of the taxpayer's family, or both;

(B) Thirty percent of the business is owned, directly or indirectly, by any combination of the taxpayer or members of the taxpayer's family, or both, and at least:

(I) Seventy percent of the business is owned, directly or indirectly, by members of two families; or

(II) Ninety percent of the business is owned, directly or indirectly, by members of three families.

(g) "Substantially all" means at least 90 percent.

NEW SECTION. **Sec.**  (1) For purposes of the tax imposed under this chapter, long-term capital gains and losses are allocated to Washington as follows:

(a) Long-term capital gains or losses from the sale or exchange of tangible personal property are allocated to this state if the property was located in this state at the time of the sale or exchange. Long-term capital gains or losses from the sale or exchange of tangible personal property are also allocated to this state even though the property was not located in this state at the time of the sale or exchange if:

(i) The property was located in the state at any time during the taxable year in which the sale or exchange occurred or the immediately preceding taxable year;

(ii) The taxpayer was a resident at the time the sale or exchange occurred; and

(iii) The taxpayer is not subject to the payment of an income or excise tax legally imposed on the long-term capital gains or losses by another taxing jurisdiction.

(b) Long-term capital gains or losses derived from intangible personal property are allocated to this state if the taxpayer was domiciled in this state at the time the sale or exchange occurred.

(2)(a) A credit is allowed against the tax imposed in section 103 of this act equal to the amount of any legally imposed income or excise tax paid by the taxpayer to another taxing jurisdiction on capital gains derived from capital assets within the other taxing jurisdiction to the extent such capital gains are included in the taxpayer's Washington capital gains. The amount of credit under this subsection may not exceed the total amount of tax due under this chapter, and there is no carryback or carryforward of any unused credits.

(b) As used in this section, "taxing jurisdiction" means a state of the United States other than the state of Washington, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any foreign country or political subdivision of a foreign country.

NEW SECTION. **Sec.**  (1)(a) Except as otherwise provided in this section or RCW 82.32.080, taxpayers owing tax under this chapter must file, on forms prescribed by the department, a return with the department on or before the date the taxpayer's federal income tax return for the taxable year is required to be filed.

(b)(i) Except as provided in (b)(ii) of this subsection (1), returns and all supporting documents must be filed electronically using the department's online tax filing service or other method of electronic reporting as the department may authorize.

(ii) The department may waive the electronic filing requirement in this subsection for good cause as provided in RCW 82.32.080.

(2) In addition to the Washington return required to be filed under subsection (1) of this section, taxpayers owing tax under this chapter must file with the department on or before the date the federal return is required to be filed a copy of the federal income tax return along with all schedules and supporting documentation.

(3) Each taxpayer required to file a return under this section must, without assessment, notice, or demand, pay any tax due thereon to the department on or before the date fixed for the filing of the return, regardless of any filing extension. The tax must be paid by electronic funds transfer as defined in RCW 82.32.085 or by other forms of electronic payment as may be authorized by the department. The department may waive the electronic payment requirement for good cause as provided in RCW 82.32.080. If any tax due under this chapter is not paid by the due date, interest and penalties as provided in chapter 82.32 RCW apply to the deficiency.

(4) The department may by rule require that certain individuals and other persons file, at times and on forms prescribed by the department, informational returns for any period.

(5) If a taxpayer has obtained an extension of time for filing the federal income tax return for the taxable year, the taxpayer is entitled to the same extension of time for filing the return required under this section if the taxpayer provides the department, before the due date provided in subsection (1) of this section, the extension confirmation number or other evidence satisfactory to the department confirming the federal extension. An extension under this subsection for the filing of a return under this chapter is not an extension of time to pay the tax due under this chapter.

(6)(a) If any return due under subsection (1) of this section, along with a copy of the federal income tax return, is not filed with the department by the due date or any extension granted by the department, the department must assess a penalty in the amount of five percent of the tax due for the taxable year covered by the return for each month or portion of a month that the return remains unfiled. The total penalty assessed under this subsection may not exceed 25 percent of the tax due for the taxable year covered by the delinquent return. The penalty under this subsection is in addition to any penalties assessed for the late payment of any tax due on the return.

(b) The department must waive or cancel the penalty imposed under this subsection if:

(i) The department is persuaded that the taxpayer's failure to file the return by the due date was due to circumstances beyond the taxpayer's control; or

(ii) The taxpayer has not been delinquent in filing any return due under this section during the preceding five calendar years.

NEW SECTION. **Sec.**  (1) If the federal income tax liabilities of both spouses are determined on a joint federal return for the taxable year, they must file a joint return under this chapter.

(2) Except as otherwise provided in this subsection, if the federal income tax liability of either spouse is determined on a separate federal return for the taxable year, they must file separate returns under this chapter. State registered domestic partners may file a joint return under this chapter even if they filed separate federal returns for the taxable year.

(3) In any case in which a joint return is filed under this section, the liability of each spouse or state registered domestic partner is joint and several, unless:

(a) The spouse is relieved of liability for federal tax purposes as provided under Title 26 U.S.C. Sec. 6015 of the internal revenue code; or

(b) The department determines that the domestic partner qualifies for relief as provided by rule of the department. Such rule, to the extent possible without being inconsistent with this chapter, must follow Title 26 U.S.C. Sec. 6015.

NEW SECTION. **Sec.**  Except as otherwise provided by law and to the extent not inconsistent with the provisions of this chapter, chapter 82.32 RCW applies to the administration of taxes imposed under this chapter.

NEW SECTION. **Sec.**  (1) Any taxpayer who knowingly attempts to evade payment of the tax imposed under this chapter is guilty of a class C felony as provided in chapter 9A.20 RCW.

(2) Any taxpayer who knowingly fails to pay tax, make returns, keep records, or supply information, as required under this title, is guilty of a gross misdemeanor as provided in chapter 9A.20 RCW.

NEW SECTION. **Sec.**  A new section is added to chapter 82.04 RCW to read as follows:

(1) To avoid taxing the same sale or exchange under both the business and occupation tax and capital gains tax, a credit is allowed against taxes due under this chapter on a sale or exchange that is also subject to the tax imposed under section 103 of this act. The credit is equal to the amount of tax imposed under this chapter on such sale or exchange.

(2) The credit may be used against any tax due under this chapter.

(3) The credit under this section is earned in regards to a sale or exchange, and may be claimed against taxes due under this chapter, for the tax reporting period in which the sale or exchange occurred. The credit claimed for a tax reporting period may not exceed the tax otherwise due under this chapter for that tax reporting period. Unused credit may not be carried forward or backward to another tax reporting period. No refunds may be granted for unused credit under this section.

(4) The department must apply the credit first to taxes deposited into the general fund. If any remaining credit reduces the amount of taxes deposited into the workforce education investment account established in RCW 43.79.195, the department must notify the state treasurer of such amounts monthly, and the state treasurer must transfer those amounts from the general fund to the workforce education investment account.

NEW SECTION. **Sec.**  (1) All taxes, interest, and penalties collected under this chapter shall be distributed as follows:

(a) The first $350,000,000 collected each fiscal year shall be deposited into the education legacy trust account created in RCW 83.100.230;

(b) The next $100,000,000 collected each fiscal year shall be deposited into the general fund; and

(c) Any remainder collected each fiscal year shall be deposited into the taxpayer fairness account hereby created in the state treasury.

(2) The amounts specified under subsection (1)(a) and (b) of this section shall be adjusted annually as provided under section 115 of this act.

NEW SECTION. **Sec.**  (1) Beginning December 2023 and each December thereafter, the department must adjust the applicable amounts by multiplying the current applicable amounts by one plus the percentage by which the most current consumer price index available on December 1st of the current year exceeds the consumer price index for the prior 12-month period, and rounding the result to the nearest $1,000. If an adjustment under this subsection (1) would reduce the applicable amounts, the department must not adjust the applicable amounts for use in the following year. The department must publish the adjusted applicable amounts on its public website by December 31st. The adjusted applicable amounts calculated under this subsection (1) take effect for taxes due and distributions made, as the case may be, in the following calendar year.

(2) For purposes of this section, the following definitions apply:

(a) "Applicable amounts" means:

(i) The threshold exclusion under section 102(13) of this act;

(ii)  The worldwide gross revenue amount under section 107 of this act; and

(iii) The distribution amounts provided in section 114 of this act.

(b) "Consumer price index" means the consumer price index for all urban consumers, all items, for the Seattle area as calculated by the United States bureau of labor statistics or its successor agency.

(c) "Seattle area" means the geographic area sample that includes Seattle and surrounding areas.

**Part II**

**Miscellaneous Provisions**

NEW SECTION. **Sec.**  The provisions of RCW 82.32.805 and 82.32.808 do not apply to this act.

NEW SECTION. **Sec.**  Sections 101 through 112, 114, and 115 of this act constitute a new chapter in Title 82 RCW.

NEW SECTION. **Sec.**  (1) If a court of competent jurisdiction, in a final judgment not subject to appeal, adjudges section 103 of this act unconstitutional, or otherwise invalid, in its entirety, section 113 of this act is null and void in its entirety. Any credits previously claimed under section 113 of this act must be repaid within 30 days of the department of revenue's notice to the taxpayer of the amount due.

(2) If the taxpayer fails to repay the credit by the due date, interest and penalties as provided in chapter 82.32 RCW apply to the deficiency.

NEW SECTION. **Sec.**  If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected.

**--- END ---**