

---

## Finance Committee

---

### HB 1496

**Brief Description:** Creating a more progressive tax system in Washington by enacting an excise tax on sales and extraordinary profits of high valued assets.

**Sponsors:** Representatives Senn, Walen, Davis, Johnson, J., Ramel, Bergquist, Macri, Gregerson, Simmons, Sells, Peterson, Bateman, Berry, Lekanoff, Frame, Fitzgibbon, Duerr, Hackney, Slatter, Kirby, Thai, Chopp, Valdez, Riccelli, Pollet, Ormsby, Harris-Talley and Stonier.

**Brief Summary of Bill**

- Imposes a 7 percent tax on Washington capital gains realized from the sale of long-term assets that are real property.
- Imposes a 9.9 percent tax on Washington capital gains realized from the sale of all other long-term assets.
- Directs the proceeds of the tax to the Fair Start for Kids Account and the State General Fund.

**Hearing Date:** 2/11/21

**Staff:** Tracey O'Brien (786-7152).

**Background:**

Capital Gains.

Most property owned by an individual for personal purposes is considered a capital asset, including houses, furniture, cars, stocks, and bonds. The sale of these items may result in a capital loss or a capital gain. Short-term capital gains or losses are gains or losses from assets held for one year or less. Long-term capital gains or losses are gains or losses from assets held for more than one year.

---

*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.*

At the federal level, the gains on some of these capital assets may be subject to taxation, and the losses may be deducted, when computing an individual's net capital gain for tax liability purposes.

Some property is exempted from federal capital gains tax. This includes: stock in trade and other inventory; accounts or notes receivable; depreciable property; real estate used in a trade or business; and certain hedging transactions. In addition, an individual may not need to report the sale or exchange of a main home.

An individual filing a 1040 federal return calculates any capital gains or losses on Form 8949 and reports the gain or loss on Schedule D. Capital gains are generally taxed at a lower rate than other income. The rates are determined by the source of the net capital gain and the taxpayer's regular income tax rate. For tax year 2019, the five maximum capital gains rates are 0 percent, 15 percent, 20 percent, 25 percent, and 28 percent. For example, if the net capital gain resulted from the sale of collectibles, the 28 percent rate applies; however, if the gain is not from the sale of collectibles, small business stock, or an unrecaptured section 1250 gain, and the regular tax rate that would apply is 10 or 15 percent, then the capital gains tax rate is 0 percent.

2019 Federal Capital Gains Tax Rates (Internal Revenue Service Publication 550):

Source of net capital gain	Maximum capital gain rate
Collectibles	28%
Eligible gain on qualified small business stock minus the section 1202 exclusion	28%
Unrecaptured section 1250 gain	25%
Other gain and the regular tax that would apply is 37%	20%
Other gain and the regular tax rate that would apply is 22%, 24%, 32%, or 35%	15%
Other gain and regular tax rate that would apply is 10% or 12%	0%

"Other gain" means any gain that is not a collectibles gain, gain on small business stock, or unrecaptured section 1250 gain.

Like-Kind Exchanges.

Taxpayers can defer their federal capital gain or loss if the proceeds from the sale or exchange are reinvested in similar property as part of a qualifying like-kind exchange. The United States Internal Revenue Code (IRC) Section 1031 allows for individuals, C corporations, S corporations, partnerships, limited liability companies, trust and other taxpaying entities to engage in like-kind exchanges.

There are three types of like-kind exchanges under Section 1031. The simplest is a simultaneous swap of one property for another. A deferred exchange occurs when the disposition of the

relinquished property and acquisition of the replacement property are mutually dependent parts of an integrated transaction constituting an exchange of property. A reverse exchange involves the acquisition of replacement property through an exchange accommodation titleholder, with whom it is parked for no more than 180 days. During the parking period, the taxpayer disposes of its relinquished property to close the exchange.

As a result of the Tax Cuts and Jobs Act of 2017, Section 1031 only applies to exchanges of real property. An exchange of real property held primarily for sale does not qualify as a like-kind exchange. Real properties are generally of like-kind under the IRC regardless of whether the properties are improved or unimproved.

#### Tax Preference Performance Statement.

State law provides for a range of tax preferences that confer reduced tax liability upon a designated class of taxpayer. Tax preferences include tax exclusions, deductions, exemptions, preferential tax rates, deferrals, and credits. Currently, Washington has over 650 tax preferences, including a variety of sales and use tax exemptions. Legislation that establishes or expands a tax preference must include a Tax Preference Performance Statement (TPPS) that identifies the public policy objective of the preference, as well as specific metrics that the Joint Legislative Audit and Review Committee (JLARC) can use to evaluate the effectiveness of the preference. All new tax preferences automatically expire after 10 years unless an alternative expiration date is provided.

#### **Summary of Bill:**

Beginning January 1, 2022, a tax is imposed on the adjusted capital gains of an individual for the privilege of selling or exchanging long-term capital assets or receiving Washington capital gains. The tax is equal to 7 percent of an individual's capital gain on real property and 9.9 percent on an individual's capital gain on all other long-term capital assets.

This tax is in addition to any other taxes imposed by state and local governments.

This tax also applies to beneficial owners who are individual owners of long-term capital assets held by a pass-through or other disregarded entity, to the extent the individual's ownership interest in the entity is reported for federal tax purposes.

"Washington capital gains" are defined as an individual's adjusted capital gains allocated to Washington state, less \$200,000 for an individual or \$400,000 if filing jointly.

"Adjusted capital gain" is defined as the federal net long-term capital gain plus any loss from a sale or exchange that is exempt from the tax imposed in this chapter, and less any gain from a sale or exchange that is exempt from the tax imposed in this chapter, to the extent that such gain or loss was included in calculating federal net long-term capital gain.

Long-term assets can include real estate and intangible or tangible personal property:

- For real estate, the capital gains tax will apply if the real property sold or exchanged is in Washington, or the majority of the fair market value of the property is in this state.
- For intangible personal property, the capital gains tax will apply if the taxpayer was domiciled in Washington at the time of sale or exchange.
- For tangible personal property, the capital gains tax will apply if the property was located in Washington at the time of the sale or exchange. The sale of tangible personal property will also be subject to the state's capital gains tax if:
  - the property was located in Washington at any time during the current or immediately preceding taxable year;
  - the taxpayer was a Washington resident at the time of the sale or exchange; and
  - the sale was not subject to income or excise tax on the adjusted capital gain by another taxing jurisdiction.

Provisions are included to address like-kind exchanges. An individual who has a capital gain or loss from an exchange of Washington capital assets for non-Washington capital assets and the gain or loss is not recognized for federal income tax purposes pursuant to Section 1031 of the Internal Revenue Code (1031 exchange) must file an annual form with DOR for each subsequent year in which the gain or loss from the 1031 exchange is not recognized for federal tax purposes. These annual forms must be filed by the same date as capital gains returns are due.

A "resident" is an individual domiciled in Washington during the entire taxable year. A resident also includes a person who is not domiciled in Washington during the taxable year but maintained a place of abode and was physically present in Washington for more than 183 days during the taxable year. Such person will be a resident for that portion of the year in which they were domiciled or maintained a place of abode. If an individual maintained no permanent place of abode in this state during the entire taxable year, maintained a permanent place of abode outside of Washington for an entire taxable year, and spent an aggregate of no more than 30 days in Washington, the person is considered a nonresident.

#### Exemptions, Deductions and Credits.

The following assets are exempt from the capital gains tax:

- a principal place of residence with a selling price of \$5 million or less, so long as the residence as used as the individual's principal place of residence for at least 24 full months of the 5 years preceding the sale or exchange;
- retirement assets, including 401(k), a tax-sheltered annuity and custodial account, deferred compensation plans, individual retirement accounts (IRAs), Roth IRAs, employee defined contribution programs, employee defined benefit programs, or similar retirement saving vehicles;
- assets condemned by the government;
- cattle, horses, or breeding livestock held for more than 12 months, if 50 percent of the taxpayer's gross income for the year is from farming or ranching;
- agricultural lands for which the taxpayer has regular, continuous, and substantial involvement in the operation of the land and meets the federal criteria for "material participation" for 10 years previous to a sale;

- certain property used in a trade or business; and
- timber, timberlands, or receipts from a Real Estate Investment Trust.

A credit for Washington capital gains tax paid is available for the business and occupation tax. Credits are also allowed equal to the amount of any legally imposed income or excise tax paid by the taxpayer to another jurisdiction.

A deduction of 10 percent or \$10,000, whichever is less, is provided for any Washington real estate excise tax paid on a transaction involving real property. In addition, deductions are allowed for taxes prohibited by the United States or Washington constitutions or laws.

A deduction from the amount of adjusted capital gain is authorized for the sale of a qualified family-owned small business. The deduction is the amount of adjusted capital gain derived from the sale of at least 90 percent of all of the fair market value of the assets of, or transfer of at least 90 percent of the taxpayer's interest in, a qualified family-owned small business.

A "qualified family-owned small business" is defined as a business:

- in which the taxpayer held a qualifying interest for at least eight years immediately preceding the sale or transfer;
- in which the taxpayer or a family member materially participated in the operation of the business for at least five of the eight years immediately preceding the sale or transfer, unless the sale or transfer was to a family member;
- that had no more than 50 full-time employees at any time during the 12-month period immediately preceding the sale or transfer; and
- that had a worldwide gross revenue of \$10 million or less during the 12-month period immediately preceding the sale or transfer.

"Material participation" means an individual was involved in the operation of the business on a regular, continuous, and substantial basis.

"Qualifying interest" means an interest as a proprietor in a business carried on as a sole-proprietor. It can also mean an interest in a business if at least:

- 50 percent of the business is owned, directly or indirectly, by the taxpayer and members of the taxpayer's family;
- 30 percent of the business is owned, directly or indirectly, by the taxpayer and members of the taxpayer's family, and at least 70 percent of the business is owned, directly or indirectly, by members of two families; or
- 30 percent of the business is owned, directly or indirectly, by the taxpayer and members of the taxpayer's family, and at least 90 percent of the business is owned, directly or indirectly, by members of three families.

#### Tax Proceeds.

From January 1, 2022 through June 30, 2025, 50 percent of the tax proceeds under this act must be deposited in the Fair Start for Kids account created in House Bill 1213 and 50 percent must be

deposited into the State General Fund. Beginning July 1, 2025, 60 percent of the tax proceeds under this act must be deposited into the Fair Start for Kids Account and 40 percent must be deposited in the State General Fund.

Other Provisions.

The administrative provisions for the Department of Revenue (DOR) apply to this new tax, and additional provisions for the filing, payment, and applicable penalties are included. The DOR may enter into reciprocal agreements with other states to offset delinquent taxes. Persons are required to file, even if they do not owe Washington capital gains taxes, if their Washington capital gain for the calendar year is at least \$150,000 if an individual, \$300,000 if married and filing jointly.

It is a class C felony to knowingly attempt to evade payment of the capital gains tax. It is a gross misdemeanor to knowingly fail to pay tax, make returns, keep records, or supply information required.

This act is exempt from the requirements of a TPPS, a JLARC review, and the exemptions do not expire.

**Appropriation:** None.

**Fiscal Note:** Requested on February 4, 2021.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.