
Finance Committee

ESSB 5096

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).

<p>Brief Summary of Engrossed Substitute Bill</p> <ul style="list-style-type: none">• Imposes a 7 percent tax on Washington capital gains realized from the sale of long-term assets.
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Hearing Date: 3/15/21

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.

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.

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.

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.

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 Engrossed Substitute 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 long-term capital assets.

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

This tax also applies natural persons and to individuals who are beneficial 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. This includes a grantor of a nongrantor trust when the grantor's transfer of assets to the trust is treated as an incomplete gift for federal gift tax purposes.

"Washington capital gains" are defined as an individual's adjusted capital gains allocated to Washington state less a standard deduction of \$250,000 for all filers, whether filing as an individual or jointly. The standard deduction will be annually adjusted for inflation.

"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 include intangible or tangible personal property:

- 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.

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:

- all real estate;
- controlling interest in an entity that sold property subject to real estate excise tax to the extent capital gain or loss is from the controlling interest sale is directly attributable to real property;
- 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, if 50 percent of the taxpayer's gross income for the year is from farming or ranching;
- certain depreciable property used in a trade or business;
- goodwill received from the sale of an automobile dealership; 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. 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; and
- that had a worldwide gross revenue of \$10 million or less during the 12-month period immediately preceding the sale or transfer. The amount of the world-wide gross revenue limit must be adjusted annually for inflation.

"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.

The proceeds from the tax must be distributed as follows, adjusted annually for inflation:

- The first \$350,000,000 collected each fiscal year must be deposited into the Education Legacy Trust Account;
- The next \$100,000,000 collected each fiscal year must be deposited in the State General Fund; and
- The remainder each fiscal year will be deposited into the newly created Taxpayer Fairness Account.

Adjustments.

Each year beginning with calendar year 2024, the Department of Revenue (DOR) must adjust the standard deduction, the worldwide gross revenues of a qualifying family owned business and the distribution amounts for the tax proceeds. The amounts will be adjusted by the current consumer price index for all urban consumers for the Seattle metropolitan as calculated by the United States Bureau of Labor Statistics for the proceeding 12 months plus one.

Other Provisions.

The administrative provisions for the DOR apply to this new tax, and additional provisions for the filing, payment, and applicable penalties are included.

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: Available.

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