FINAL BILL REPORT
ESSB 5096

C 196 L 21
Synopsis as Enacted

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.


Senate Committee on Ways & Means
House Committee on Finance

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. 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.

The Education Legacy Trust Account (ELTA) was created in 2005. Money in the ELTA may only be used for K-12 and higher education purposes; however, for the past several fiscal biennia, state operating budgets have authorized funds in the ELTA to be used for supporting early learning programs.

Summary: Beginning January 1, 2022, an annual state net CGT is imposed on the sale or exchange of certain capital assets.
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. However, for married couples filing separately and registered domestic partners filing separately, the combined standard deduction is limited to $250,000. 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;
- interests in a privately held entity to the extent any long-term capital gain or loss is directly attributable to the real estate owned directly by the entity;
- 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;
- commercial fishing privileges; 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 five 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 ten 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.
A taxpayer may deduct from the measure of Washington capital gains the amount donated by the taxpayer to one or more qualified organizations during the same taxable year in excess of $250,000. The deduction may not exceed $100,000 for the taxable year. The charitable donations deduction is adjusted annually for inflation. A qualified organization is a nonprofit organization or any other organization eligible to receive a charitable deduction under the federal tax code and principally directed or managed within the state of Washington.

Revenues from the tax, and any associated interest and penalties, are distributed as follows: the first $500 million of state CGT revenues received each year are deposited into the state Education Legacy Trust Account and the remainder is deposited into the Common School Construction Account. Beginning with taxes due and payable in 2024, the $500 million amount is adjusted by inflation. The Education Legacy Trust Account is amended to permanently allow funds to be used for early learning and child care programs.

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

The bill specifies the tax is necessary for the support of state government and its existing institutions.

**Votes on Final Passage:**

- Senate 25 24
- House 53 45 (House amended)
- House 52 46 (House vote on third reading reconsidered)
  
  (Senate refused to concur/asked House for conference)

**Conference Committee**

- House 52 44
- Senate 25 24

**Effective:** July 25, 2021