HOUSE BILL REPORT
SSB 5314

As Reported by House Committee On:
Finance

Title: An act relating to modifying the capital gains tax under chapter 82.87 RCW and related statutes by closing loopholes, replacing the business and occupation tax credit with a capital gains tax credit, clarifying ambiguities and making technical corrections in a manner that is not estimated to affect state or local tax collections, modifying the credit for taxes paid in other jurisdictions, treating spouses and domestic partners more consistently, modifying and adding definitions, creating a late payment penalty waiver, modifying the publication schedule for inflation adjustments, modifying the distributions of moneys to the following fiscal year instead of calendar year, adding a nonclaim period, and adding a new requirement for brokers and barter exchanges.

Brief Description: Modifying the capital gains tax.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Stanford, Harris and Nobles; by request of Department of Revenue).

Brief History:
Committee Activity:
Finance: 3/20/25 [DP].

Brief Summary of Substitute Bill

- Clarifies the provisions of the capital gains tax and makes technical corrections and changes to enhance administration of the tax.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 14 members: Representatives Berg, Chair; Street, Vice Chair; Orcutt, Ranking Minority Member; Jacobsen, Assistant Ranking Minority Member; Abell, Chase, Mena, Parshley, Ramel, Santos, Scott, Springer, Walen and Wylie.

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.

Minority Report: Do not pass. Signed by 1 member: Representative Penner.

Staff: Tracey Taylor (786-7152).

Background:

Capital Gains Tax.
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. These capital gains and losses may have federal and state tax implications for an individual.

The state imposes a 7 percent excise tax on the adjusted capital gains of an individual for the privilege of selling or exchanging long-term capital assets less a standard deduction of $250,000 for all filers, whether filing as an individual or jointly. The standard deduction is adjusted annually 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 Washington capital gains tax imposed, to the extent that such gain or loss was included in calculating federal net long-term capital gain.

The tax applies only to those capital gains allocated to Washington, which means the long-term capital assets for the taxpayer must have certain ties to Washington.

For intangible personal property, the state capital gains tax will apply if the taxpayer was domiciled in Washington at the time of the sale or exchange. A "resident" is a person:

- domiciled in Washington during the entire taxable year; or
- not domiciled in Washington during the taxable year but who maintained a place of abode and was physically present in Washington for more than 183 days during the taxable year; such a person will be a resident for that portion of the year in which they were domiciled or maintained a place of abode.

If a person 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.

The state capital gains tax applies to tangible personal property if:

- the property was located in Washington at the time of the sale or exchange; or
- 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.

The sales or exchanges of the following types of assets are exempt from the state capital gains tax:

- real estate;
- interest in an entity owning real property, but only to the extent that any long-term capital gain or loss from such sale or exchange is directly attributable to the real estate owned directly by such entity;
- common types of retirement assets;
- 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;
- commercial fishing privileges;
- 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.

There are credits and deductions available to reduce or eliminate a person's tax liability, which include:

- a credit to reduce business and occupation (B&O) tax liability based on the payment of the Washington capital gains tax;
- a credit to reduce a person's Washington capital gains tax liability based on the payment of income or excise tax imposed on the asset and paid by the person to another jurisdiction;
- a deduction for taxes prohibited by the United States (US) or Washington constitutions or laws;
- a deduction from the amount of adjusted capital gain for qualified charitable donations; and
- a deduction from the amount of adjusted capital gain for the sale of a qualified family-owned small business.

The Education Legacy Trust Account (ELTA) is used to fund kindergarten through grade 12 and higher education purposes as well as childcare and early learning programs. The Common School Construction Account (CSCA) is appropriated through the biennial state capital budget to provide financing for the construction of facilities for common schools.

The first $500 million in taxes, penalties, and interest collected from the state capital gains tax each fiscal year must be deposited into the ELTA. Any remaining proceeds are deposited into the CSCA. The amount deposited in the ELTA is adjusted annually for inflation.

Section 1256 Contract.

A section 1256 contract is defined by the US Internal Revenue Service (IRS) as any regulated futures contract, a foreign currency contract, a nonequity option, a dealer equity option, or a dealer securities futures contract. A section 1256 contract does not include certain swaps or other hedging transactions.

For the purposes of reporting gains and losses on a federal tax return, the "marked-to-market" rules applies to section 1256 contracts. This means that a section 1256 contract held by a taxpayer at the close of a tax year is treated as if it were sold for its fair market value on the last business day of the year. As a result, the taxpayer must recognize any gain or loss that results. Under the "marked-to-market" system, 60 percent of the capital gain or loss will be treated as a long-term capital gain or loss, and 40 percent will be treated as a short-term capital loss. This rule applies regardless of how long the taxpayer has held the section 1256 contract.

Form 1099-B.
The IRS requires a broker or barter exchange to file a Form 1099-B for each person:

- for whom, the broker or barter exchange sold stocks, commodities, regulated futures contracts, foreign currency contracts, debt instruments, options, securities futures contracts, and similar assets for cash; and
- who received cash, stock, or other property from a corporation that the broker knows or has reason to know has had its stock acquired in an acquisition of control or had a substantial change in capital structure; or who exchanged property or services through a barter exchange.

Summary of Bill:

Business and Occupation Tax Credit.
The current B&O tax credit is repealed, effective January 1, 2026; however, a taxpayer's right to claim the B&O tax credit from sales and exchanges that occurred prior to the repeal is preserved. In addition, a taxpayer's liability for tax, penalty, or interest related to this credit for tax years prior to the repeal are preserved.

A nonrefundable credit against an individual's Washington capital gains tax liability for sales and exchanges subject to both capital gains tax and B&O tax is effective January 1, 2026. The credit may not be carried forward or backward.

The State Treasurer is directed to make quarterly transfers to the ELTA and CSCA in an amount equal to the reduction in capital gains tax collected as the result of the capital gains tax credit for B&O taxes paid.

Adjusted Capital Gain.
The definition of an "adjusted capital gain" is clarified to address long-term capital losses.

The following carried forward long-term capital losses must be added to the federal net long-term capital gain when calculating the Washington "adjusted capital gain":

- a long-term capital loss from a sale or exchange that is exempt from the Washington capital gains tax; and
- a long-term capital loss from a sale or exchange that occurred prior to January 1, 2022.

In addition, the amount of a long-term capital gain or loss from the sale or exchange of a section 1256 contract that was held for more than one year must be added, if not included in the calculation of the federal net long-term capital gain.

Tangible and Intangible Personal Property.
Definitions of tangible and intangible personal property are added. "Tangible personal property" is personal property that can be seen, weighed, measured, felt, or touched. It does not include steam, electricity, or electrical energy. "Intangible personal property" is personal property that is not tangible personal property.

Retirement Accounts.
Retirement accounts can be foreign or domestic for the purposes of the capital gains exemption so long as the account penalizes withdrawals prior to the legal or beneficial owner reaching a certain age.

Spouses and Registered Domestic Partners.
Treatment of spouses and registered domestic partners is clarified, regardless of whether they file federal income tax returns jointly or separately. This includes clarifying the application of the standard deduction.

Qualified Family-Owned Business Deduction.
A clarification is made to the qualified family-owned business deduction. In calculating an individual's holding period for a qualifying interest, a change in its entity type or a nonmaterial change will not reset the holding period.

Qualified Charitable Deduction.
When determining if a charitable deduction is given to a qualified organization, a definition for "principally directed and managed" within Washington is added. It means the place where a qualified organization's activities are primarily directed, controlled, and coordinated.

Credit for Taxes Paid to Another Taxing Jurisdiction.
In order to qualify for a credit for taxes paid to another taxing jurisdiction, the taxpayer's long-term capital asset must be subject to tax in both Washington and the other taxing jurisdiction. This credit is nonrefundable.

Filing a Washington Capital Gains Tax Return.
A taxpayer only needs to included federal forms, schedules, and supporting documents that relate to capital gains. Other materials need only be provided at the request of the Department of Revenue (DOR).

If a taxpayer receives a federal filing extension, the taxpayer must provide evidence of the federal filing extension on or before the filing deadline for the Washington capital gains tax.

If a taxpayer amends a federal tax return in a manner than impacts the taxpayer's Washington capital gains liability, the taxpayer must file an amended Washington capital gains tax return within 90 days.

Penalties and Interest.
A late filing penalty waiver may only be claimed if the taxpayer has not been contacted by the DOR for enforcement purposes for the period covered by the waiver.

A late payment penalty waiver is allowed for taxpayers that have remitted payments on time for the previous five years and who have not been contacted by the DOR for enforcement purposes.

Failure to amend a Washington capital gains tax return is subject to a 5 percent penalty for each month that the return is not amended, with a maximum penalty of 25 percent.

Computation of interest in the event of an underpayment or overpayment will be handled in the same manner as with annual files of the combined excise tax return.

In the event of a substantial underpayment of a capital gains tax, a penalty of 5 percent of the actual amount of tax due is assessed. "Substantial underpayment" means that the taxpayer's estimated payment was less than 80 percent of the capital gains tax actually due, and at least $1,000.

Inflation Adjustments.
The publication schedule of inflation adjustments of the standard deduction, the qualified charitable deduction, and the distributions to the ELTA and CSCA is updated. The distribution adjustments will take effect at the beginning of the following fiscal year.

Form 1099-B.
Broker and barter exchanges must provide the DOR with IRS Form 1099-B for sales and exchanges of long-term capital assets when the gain for sale or exchange is allocated to Washington and the broker or barter exchange is the payor.

There is a rebuttable presumption that the long-term capital gain is allocated to Washington if:

- the payee's last known place of domicile to the payor is located in Washington;

- the payee's address on file with the broker or barter exchange is located in Washington;
- the payee's address on the Form 1099-B is located in Washington;
- the payee's account with the broker or barter exchange was opened in Washington; or
- the payee makes use of a broker or barter exchanges' physical place of business in Washington.

The 1099-B form must be sent electronically to the DOR no later than 90 days after filing the form with the IRS. There is a penalty of $50 for each failure to provide or the willful filing of a false or fraudulent copy of a 1099-B form.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains multiple effective dates. Please see the bill.

Staff Summary of Public Testimony:

No public hearing was held.

Persons Testifying: No public hearing was held.

Persons Signed In To Testify But Not Testifying: No public hearing was held.