SENATE BILL REPORT
SB 5314

As of January 28, 2025

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: Senators Stanford, Harris and Nobles; by request of Department of Revenue.

Brief History:
Committee Activity: Ways & Means: 1/28/25.

Brief Summary of Bill

- Makes various technical clarifications, corrections, and administrative changes to the Washington capital gains tax.

SENATE COMMITTEE ON WAYS & MEANS

Staff: Jeffrey Mitchell (786-7438)

Background: Beginning January 1, 2022, an annual state net capital gains tax (CGT) was imposed on the sale or other voluntary exchange of long-term capital assets by individuals. The tax rate is 7 percent. 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

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State. 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 were due in 2023. Taxpayers owing tax must also file a copy of their federal tax return.

The first $270,000 of capital gains are excluded from the state CGT. The threshold is adjusted each year for 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 $10.8 million or less in the 12-month period preceding the sale or transfer of the business. The $10.8 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 $270,000. 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 $525 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. The threshold is adjusted each year by inflation.

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.

Section 1256 contracts are a type of financial instrument subject to unique tax-treatment under the federal tax code. Section 1256 contracts include regulated futures contracts and foreign currency contracts. Under the federal tax code, at the end of each tax year, all open positions in these contracts must be valued as if they were sold at their fair market value on the last business day of the year. The resulting gains or losses are then recognized for tax purposes. Gains or losses from section 1256 contracts are treated as 60 percent long-term gains and 40 percent short-term gains, regardless of the actual holding period.

If the DOR determines that any tax has been substantially underpaid, there is assessed a penalty of 5 percent of the amount of tax determined to be due. If payment of the tax is not received by the DOR by the due date specified in the notice, or any extension, there is assessed a total penalty of 15 percent of the tax determined to be due. If payment of the tax is not received on or before the 30th day following the due date, there is assessed a total penalty of 25 percent of the tax determined to be due.

Federal tax form 1099-B is used to report gains or losses from selling stocks, bonds, derivatives, or other securities through a broker, and for barter exchange transactions. The form contains details such as the description of the item sold, purchase and sale dates, acquisition cost, sale proceeds, and any federal tax withheld by the broker. The form helps a person calculate capital gains or losses, which are reported on tax returns. A broker or barter exchange must file this form for each person for whom the broker sold stocks, commodities, regulated futures contracts, foreign currency contracts, and other types of investments or exchanged property or services through a barter exchange.

Summary of Bill: The bill makes a number of technical corrections, clarifications, updates, and administrative changes, including the following:

The B&O tax credit for capital gains paid on the same property is replaced with a capital gains tax credit for B&O taxes.

In determining Washington capital gains, long-term capital loss carryforwards may not reduce the amount of tax if the loss was incurred on a sale that would not be allocated to Washington. Similarly, long-term loss carryforwards may not reduce Washington capital

gains if the transaction occurred prior to the effective date of the Washington capital gains tax.

With regard to the sale or exchange of a section 1256 contract, the entire amount is treated as a long term gain or loss if the contract was held for more than a year.

Capital gains with respect to a retirement plan are exempt from the Washington capital gains tax, regardless of whether the retirement plan is foreign or domestic, if the plan penalizes withdrawals prior to the owner reaching a certain age.

A person's holding period of a qualified family-owned small businesses is not reset if the business only changes its entity type or makes a nonmaterial change, or both.

The requirement that a taxpayer must include their federal return in their Washington tax filing is narrowed to only those federal documents used directly in the calculation of the taxpayer's federal net long-term capital gain.

DOR is authorized to waive or cancel penalties on the delinquent payment of taxes if the taxpayer requests a waiver, the taxpayer has not been contacted by DOR for enforcement purposes regarding the reporting period covered by the waiver, and the taxpayer has timely remitted payment on all tax returns due under this section during the preceding five years.

If a taxpayer's federal income tax return is changed in a way that modifies a taxpayer's Washington capital gains tax liability, the taxpayer must amend their Washington capital gains tax return. If the Washington capital gains tax return is not amended within 90 days of the federal income tax return change becoming final, the taxpayer will be assess a penalty of 5 percent of any additional state tax due for each month the Washington return is not timely amended. The maximum penalty is 25 percent.

DOR may not assess additional taxes, penalties, or interest more than four years after the year in which a Washington capital gains tax return is filed except if: the taxpayer's federal tax return is changed in a way that requires the Washington capital tax return to be amended; there is a showing of fraud or of misrepresentation of a material fact by the taxpayer; or where a taxpayer has executed a written waiver of such limitation.

Additional clarification is made with respect to individuals who are spouses or state registered domestic partners. Regardless of whether the individuals file a joint or separate return for the Washington capital gains tax, the activities and assets of each spouse or domestic partner are combined as if they were one individual for the purposes of determining the applicability of any threshold amounts, caps, deductions, credits, or any other amounts related to the activities or assets of an individual throughout the chapter.

For an estimated tax payment made in April, the maximum penalty for substantially underpaying the Washington capital gains tax is 5 percent of the actual tax due.

A broker or barter exchange must provide copies of federal tax form 1099-B to the DOR where the broker or exchange sold or otherwise exchanged property generating a long-term capital gain that will be allocated to Washington.

Appropriation: None.

Fiscal Note: Available.

Creates Committee/Commission/Task Force that includes Legislative members: No.

Effective Date: Sections 3, 4, 8, 10, and 15 bill takes effect on January 1, 2026.