

WSR 22-22-101

PROPOSED RULES

DEPARTMENT OF REVENUE

[Filed November 2, 2022, 9:46 a.m.]

Original Notice.

Preproposal statement of inquiry was filed as WSR 22-18-097.

Title of Rule and Other Identifying Information: WAC 458-20-300
Capital gains excise tax—Overview and administration.

Hearing Location(s): On December 6, 2022, at 10:00 a.m., hybrid, in-person and virtual meeting. In person at Room 252, 6400 Linderson Way [S.W.], Tumwater, WA. To attend virtually by phone or video conference, contact Sierra Crumbaker at SierraC@dor.wa.gov for dial-in/login information.

Date of Intended Adoption: December 28, 2022.

Submit Written Comments to: Michael Hwang, 6400 Linderson Way S.W., Tumwater, WA 98504, email MichaelHw@dor.wa.gov, 360-534-1575, by December 9, 2022.

Assistance for Persons with Disabilities: Contact Julie King, phone 360-704-5733.

Purpose of the Proposal and Its Anticipated Effects, Including Any Changes in Existing Rules: This proposed new rule seeks to clarify administrative aspects of the excise tax on capital gains such as proper filing procedures and penalties related to this excise tax.

Reasons Supporting Proposal: This rule will provide useful information on filing and payment procedures for the new capital gains excise tax.

Effective January 1, 2022, chapter 82.87 RCW imposes an excise tax on sales or exchanges of long-term capital assets. In March of 2022, the Douglas County superior court ruled in *Quinn v. State of Washington* that the excise tax on capital gains does not meet state constitutional requirements and, therefore, is unconstitutional and invalid. The state has appealed the ruling to the Washington supreme court. While the appeal is pending, the department will continue to provide guidance, such as this rule, to the public regarding the tax as a courtesy. This rule will apply only if the tax is ruled constitutional and valid by the Washington supreme court.

Statutory Authority for Adoption: RCW 82.01.060, 82.32.300.

Statute Being Implemented: RCW 82.87.020, 82.87.040, 82.87.050, 82.87.060, 82.87.110, 82.87.120, 82.87.130.

Rule is not necessitated by federal law, federal or state court decision.

Name of Proponent: Department of revenue, governmental.

Name of Agency Personnel Responsible for Drafting: Michael Hwang, 6400 Linderson Way S.W., Tumwater, WA, 360-534-1576; Implementation and Enforcement: Heidi Geathers, 6400 Linderson Way S.W., Tumwater, WA, 360-531-1615.

A school district fiscal impact statement is not required under RCW 28A.305.135.

A cost-benefit analysis is not required under RCW 34.05.328. This proposed rule is not a significant legislative rule.

Scope of exemption for rule proposal from Regulatory Fairness Act requirements:

Is not exempt.

The proposed rule does not impose more-than-minor costs on businesses. Following is a summary of the agency's analysis showing how costs were calculated. The proposed rule is aimed at individuals rath-

er than businesses, so the proposed rule does not impose more-than-minor costs on businesses as defined by RCW 19.85.020(2). In addition, the proposed rule does not create any liability for taxes or fees, reporting requirements, recordkeeping requirements, or compliance requirements not already otherwise imposed by statute.

November 2, 2022
Atif Aziz
Rules Coordinator

OTS-4078.3

NEW SECTION

WAC 458-20-300 Capital gains excise tax—Overview and administration. (1) **Introduction and overview.** Beginning January 1, 2022, Washington law imposes an excise tax on individuals with sales or exchanges of long-term capital assets (capital gains excise tax). See RCW 82.87.040. This rule provides information regarding the administration of the capital gains excise tax and is divided into six subsections as follows: Introduction and overview; returns; extensions; payment of tax; penalties and interest; and general administration.

(a) **Imposition.** The capital gains excise tax is imposed on the sale or exchange of long-term capital assets. The capital gains excise tax is not imposed on any sale or exchange occurring prior to January 1, 2022. A "long-term capital asset" is a capital asset that is held for more than one year. A "capital asset" has the same meaning as provided by section 1221 of the federal Internal Revenue Code and includes any other property if the sale or exchange of the property results in a gain that is treated as a long-term capital gain under section 1231 or any other provision of the federal Internal Revenue Code.

(b) **Who is taxable?** Only individual natural persons (referred to in this rule as "taxpayer," "you," or "your") are subject to the capital gains excise tax.

(c) **What is the tax rate?** The tax rate is seven percent. The tax is calculated by multiplying a taxpayer's Washington capital gains by the seven percent tax rate.

(d) **Washington capital gains.** Washington capital gains is your federal net long-term capital gain with certain adjustments made under RCW 82.87.020 (1)(a) through (e) and further modified by the deductions in RCW 82.87.060. The adjustments are primarily aimed at removing capital gains and losses allocated to places outside of Washington from your Washington capital gains figure.

(i) "Federal net long-term capital gain" means the net long-term capital gain reportable for federal income tax purposes, determined as if Title 26 U.S.C. Secs. 55 through 59 and 1400Z-1 and 1400Z-2 of the federal Internal Revenue Code did not exist. Title 26 U.S.C. Secs. 55 through 59 relate to the alternative minimum tax and Title 26 U.S.C. Secs. 1400Z-1 and 1400Z-2 relate to opportunity zones.

(ii) The deductions in RCW 82.87.060 are as follows:

(A) A standard deduction. If you are married or a state-registered domestic partner, the total combined standard deduction for both you and your spouse or domestic partner is \$250,000, regardless of

whether you and your spouse or domestic partner file a joint or separate return. In all other cases, the standard deduction is \$250,000 per individual natural person. The \$250,000 deduction amount may be adjusted for inflation every December, beginning in December 2023. See RCW 82.87.150 for additional information.

(B) Amounts that the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States.

(C) Adjusted capital gain derived from the sale or transfer of your interest in a qualified family-owned small business pursuant to RCW 82.87.070.

(D) Charitable donations deductible under RCW 82.87.080. The charitable donation deduction cannot exceed \$100,000. The \$100,000 deduction cap may be adjusted for inflation every December, beginning in December 2023. See RCW 82.87.150 for additional information.

(e) **Exemptions.** Certain sales or exchanges, such as sales of real estate, are exempt from the capital gains excise tax. See RCW 82.87.050 for additional information.

(f) **Examples.** This rule contains examples. These examples identify a number of facts and then state a conclusion. They are provided only as a general guide. The tax results of other situations must be determined after a review of all the facts and circumstances.

(2) **Returns.**

(a) **Filing obligation and due date.** Only taxpayers owing Washington's capital gains excise tax in a taxable year are required to file a capital gains excise tax return with the department.

(i) If you are required to file a capital gains excise tax return, you must file the return with the department on or before the date your federal income tax return is required to be filed for the same taxable year.

(ii) If you owe capital gains excise tax, you are required to file a capital gains excise tax return whether or not you filed a federal income tax return.

(iii) If you did not file a federal income tax return, the due date for your capital gains excise tax return is the date your federal income tax return would have been due.

Example 1 - Return due date

Facts: The due date for Michael's federal income tax return is April 18, 2023. Michael has a Washington capital gains excise tax liability.

Result: The capital gains excise tax return due date is April 18, 2023, which is the date Michael's federal income tax return is due. Michael must file his capital gains excise tax return on or before April 18, 2023, or the return will be late and penalties will apply.

(b) **Separate and joint filers, single filers.** If you are required to file a capital gains excise tax return, your federal income tax filing status may affect how you must file your capital gains excise tax return as follows:

(i) Spouses filing jointly. Spouses who file a joint federal income tax return for the taxable year must file a joint capital gains excise tax return for the same taxable year. Accordingly, if you are married, and file a joint federal income tax return with your spouse, you must file a joint capital gains excise tax return with your spouse.

(ii) Spouses filing separately. If a spouse files a separate federal income tax return for the taxable year, each spouse that owes capital gains excise tax must file a separate capital gains excise tax

return for the same taxable year. Accordingly, if you are married and file a separate federal income tax return from your spouse, you must file a separate capital gains excise tax return.

(iii) State-registered domestic partners. State-registered domestic partners may file a joint capital gains excise tax return even if they filed separate federal income tax returns for the taxable year. Accordingly, if you are a state-registered domestic partner and file a separate federal income tax return from your partner, you may elect either to file a joint or separate capital gains excise tax return.

(iv) Single filers. Any individual that is not married and is not a state-registered domestic partner must file their capital gains excise tax returns as a single individual.

(c) **Required documentation with the capital gains excise tax return.** All taxpayers required to file a capital gains excise tax return for a taxable year must submit, along with the capital gains excise tax return form, all of the following:

(i) A copy of the complete, filed federal individual income tax return, including all supporting schedules and documentation filed with the Internal Revenue Service (IRS), for the taxable year.

(ii) For any claim for exemption under RCW 82.87.050(2), which may exempt the sale or exchange of an interest in a privately held entity directly owning real estate, documentation that substantiates the following:

(A) The fair market value and basis of the real estate held directly by the privately held entity;

(B) The percentage of the ownership interest sold or exchanged in the privately held entity that owns the real estate; and

(C) The methodology established by the privately held entity for allocating gains or losses from the sale of real estate among the owners, partners, or shareholders of the entity.

(d) **Incomplete returns.** A capital gains excise tax return is considered complete only if the return is filed in accordance with the filing requirements described in RCW 82.87.110 and subsection (2) of this rule. If a complete capital gains excise tax return is not filed on or before the due date for the capital gains excise tax return, the return will be late and the late filing penalty may apply. See subsection (5) of this rule for more information.

Example 2 - Incomplete return

Facts: Jane filed her federal income tax return on April 18, 2023. Jane owes capital gains excise tax and is required to file a capital gains excise tax return. She filed the return on April 18, 2023, but did not provide the department with a copy of her federal income tax return until April 30, 2023.

Result: Jane was required to file a complete return by April 18, 2023. Jane did not file a complete return on April 18, 2023, because she failed to include a copy of her federal individual income tax return along with the capital gains excise tax return. Jane's return is late. See subsection (5) of this rule for additional information on the late filing penalty.

(e) **Electronic filing.** All taxpayers must electronically file their capital gains excise tax returns and all required documentation identified in subsection (2)(c) of this rule. Electronic filings must be submitted to the department via the "My DOR" portal at www.secure.dor.wa.gov. The department may waive the electronic filing requirement for good cause as provided in RCW 82.32.080. See RCW 82.32.080 and WAC 458-20-22802 for additional information regarding electronic filing and the good cause waiver.

(f) **Amended returns.**

(i) **Amended return required.** If you or the IRS make any changes to your federal income tax return for any reason, and the changes affect the reported capital gains or the capital gains excise tax liability, you must file an amended capital gains excise tax return reflecting all changes made to the federal income tax return. You must also file an amended capital gains excise tax return if the original capital gains excise tax return needs to be corrected for errors identified after the due date for the original capital gains excise tax return, including, for example, situations where the statute of limitations for assessment of federal tax for a particular tax year is closed but the Washington nonclaim period remains open.

(ii) **Assessments and penalties.** The amendment of a capital gains excise tax return is not subject to a specific deadline. However, if the department finds that your failure to file an amended capital gains excise tax return shows evasion or misrepresentation of a material fact, the department can make assessments or corrections of assessments outside of the usual nonclaim period and impose penalties and interest at any time. See subsection (6) of this rule for more information.

(iii) **Filing and payment requirements for amended returns.** The documentation requirements described in subsection (2) of this rule apply to amended returns. This means, for instance, a copy of the complete, filed amended federal individual income tax return and all supporting amended schedules and documentation must be filed along with the amended return. If an amended capital gains excise tax return is filed and there is no amendment made to the federal tax return, other documentation supporting the changes must be submitted with the amended capital gains excise tax return. You must file your amended capital gains excise tax return electronically and electronically pay any additional tax due unless granted a waiver from the electronic filing/payment requirements by the department.

(3) **Extensions.**

(a) **Extension period; timely payment still required.** If a taxpayer obtains an extension of time for filing the federal income tax return for the taxable year and provides the department proof of the extension, the capital gains excise tax return is considered due on or before the extended due date for the federal income tax return. However, an extension for filing the capital gains excise tax return does not extend the due date for paying the capital gains excise tax.

(b) **Extension filing; certification.** You must submit an extension request electronically with the department on or before the original due date via the My DOR portal at secure.dor.wa.gov. During the submission process, you will certify that federal Form 4868, *Application for Automatic Extension of Time to File U.S. Individual Income Tax Return* or Form 2350, *Application for Extension of Time to File U.S. Income Tax Return*, was properly filed for the tax year. You must attach a copy of the properly filed federal Form 4868 or Form 2350 when filing the capital gains excise tax return.

(4) **Payment of tax.**

(a) **Due date.** If you owe the capital gains excise tax, you must remit the tax to the department on or before the date your federal income tax return is required to be filed without regard to any extension granted to you for the filing of your federal income tax return. The extension of time for filing the federal income tax return or capital gains excise tax return does not extend the due date for paying your capital gains excise tax. If you pay your capital gains excise

tax late, the late payment penalty and interest may apply. See subsection (5) of this rule for more information.

Example 3 - Late payment - No federal extension

Facts: Jeannette filed her federal income tax return on April 18, 2023. Jeannette files a capital gains excise tax return on April 18, 2023. She later remits her capital gains excise tax to the department on April 20, 2023.

Result: Jeannette was required to pay the capital gains excise tax on April 18, 2023, when her federal income tax return was due. Jeannette paid the capital gains excise tax late and is subject to penalties and interest.

Example 4 - Late payment - Federal income tax return extension

Facts: Gil requested a federal income tax return extension on April 12, 2023, and received an automatic extension of time to file his federal tax return to October 16, 2023. Gil properly submits an extension request certification to the department before April 18, 2023, the original due date for the federal tax return and capital gains excise tax return. Gil files a capital gains excise tax return and pays his capital gains excise tax on October 13, 2023.

Result: Gil paid his capital gains excise tax late and is subject to penalties and interest with respect to the late payment. While Gil extended the date for filing the capital gains excise tax return, the due date for the payment of the capital gains excise tax remained April 18, 2023.

(b) **Electronic payment.** Capital gains excise tax must be paid by electronic funds transfer or other form of department authorized electronic payment, such as by credit card. The department may waive the electronic payment requirement for good cause. See RCW 82.32.080 and WAC 458-20-22802 for additional information regarding electronic payment requirements and the good cause waiver.

(c) **Joint and several liability.** The capital gains excise tax liability of each spouse or state-registered domestic partner filing a capital gains excise tax return is joint and several unless one of the spouses is relieved of liability for federal tax purposes as provided under section 6015 of the federal Internal Revenue Code or the department determines that the domestic partner would qualify for relief under the same parameters provided in section 6015.

(5) **Penalties and interest**

(a) **Late filing penalty.** If you do not file a complete capital gains excise tax return by the due date, the department will assess a late filing penalty in the amount of five percent of the tax due for the taxable year covered by the return for each month or portion of a month that the return remains unfiled. See RCW 82.87.110. The total late filing penalty may not exceed 25 percent of the tax due for the taxable year covered by the late return.

(b) **Late payment penalty.** If you do not remit your capital gains excise tax on or before the due date for payment of the capital gains excise tax, you are subject to the late payment penalty. If payment is not received by the department by the due date, the department will assess a penalty of nine percent of the amount of the tax due; if the tax is not received on or before the last day of the month following the due date, the department will assess a total penalty of 19 percent of the amount of the tax due; and if the tax is not received on or before the last day of the second month following the due date, the department will assess a total penalty of 29 percent of the amount of the tax due. See RCW 82.32.090(1) and WAC 458-20-228 for more information regarding late payment penalties.

(c) **Other penalties.**

(i) Other penalties imposed under chapter 82.32 RCW may apply. These penalties include the penalties for substantial underpayment of tax, disregard of specific written instructions, and intent to evade tax. See RCW 82.32.090 and WAC 458-20-228 for additional information.

(ii) Any taxpayer who knowingly attempts to evade payment of the capital gains excise tax is guilty of a class C felony as provided in chapter 9A.20 RCW. Any taxpayer who knowingly fails to pay tax, make returns, keep records, or supply information required under the capital gains excise tax, is guilty of a gross misdemeanor as provided in chapter 9A.20 RCW. RCW 82.87.140.

(d) **Amended returns.** The penalties described in this subsection may apply to amended capital gains excise tax returns, except the department will not assess late return or late payment penalties on increased amounts of tax due as a result of the amendment if the original capital gains excise tax return and tax due were timely filed and paid.

(e) **Penalty waivers.**

(i) The department will waive the late filing penalty only if the department determines that:

(A) The taxpayer's failure to timely file the return was due to circumstances beyond their control; or

(B) The taxpayer has not been delinquent in filing any capital gains excise tax returns due during the preceding five calendar years.

(ii) The department will waive the late payment (RCW 82.32.090(1)) and substantial underpayment penalties (RCW 82.32.090(2)), if the department determines that the taxpayer's failure to timely pay was due to circumstances beyond their control. See RCW 82.32.105 and WAC 458-20-228 for additional information regarding waivers due to circumstances beyond the taxpayer's control.

(f) **Interest.**

(i) If you do not pay your capital gains excise tax by the due date described in subsection (4) of this rule, you will be assessed interest on the unpaid amounts. See RCW 82.32.050 and WAC 458-20-228 for additional information on interest assessed on underpayments and interest waivers.

(ii) If you have paid more tax than is properly due, you will receive interest for your overpayment. See RCW 82.32.060 and WAC 458-20-229 for information on interest on tax overpayments.

(6) **General administration**

(a) **Application of chapter 82.32 RCW.** The department administers the capital gains excise tax in accordance with chapter 82.32 RCW except as otherwise provided by law and to the extent not inconsistent with chapter 82.87 RCW.

(b) **Preserving accurate and complete records.** You have the burden of proving any claimed deductions, exemptions, and credits. Washington law requires you to keep accurate and complete records and timely respond to communications from the department. You must preserve records that substantiate the amounts of all deductions, exemptions, or credits claimed, as well as any documentation that substantiates your allocation of capital gains and losses. Claims for exemptions, deductions, and credits from the capital gains excise tax may require additional documents to be submitted to the department at the department's request. See RCW 82.32.070 and WAC 458-20-254 for additional information on recordkeeping requirements.

(c) **Refunds.** If you discover that you have overpaid taxes, penalties, or interest, you may file an amended capital gains excise tax

return or apply for a refund or credit. The provisions under WAC 458-20-229 apply to refunds of overpaid capital gains excise tax.

(d) **Informal administrative reviews.** If you disagree with the department's assessment of tax, penalties, or interest; a department letter ruling; or the department's denial of a refund, you may seek an informal review of that action by submitting a petition for review with the department's administrative review and hearings division. The petition must be filed within 30 days of the department action. See WAC 458-20-100 for additional information.

(e) **Nonclaim period.** The nonclaim period provided under RCW 82.32.050 and 82.32.060 for deficient tax or penalty payments and excess payment of tax, penalty, or interest, respectively, apply to the capital gains excise tax. However, there is no limitation for the period in which an assessment or correction of an assessment can be made upon a showing of evasion or of misrepresentation of a material fact. See RCW 82.32.050 and WAC 458-20-230.

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