WSR 24-06-089
PROPOSED RULES
DEPARTMENT OF REVENUE
[Filed March 6, 2024, 11:26 a.m.]

Continuance of WSR 23-19-070.

Preproposal statement of inquiry was filed as WSR 23-12-085.

Title of Rule and Other Identifying Information: WAC 458-20-301 Capital gains excise tax—Definitions, deductions, exemptions, and allocation of gains and losses.

Hearing Location(s): On April 9, 2024, at 1:00 p.m. This meeting will be conducted over the internet/telephone. In-person option in Tumwater also available. Contact Barbara Imperio at barbarai@dor.wa.gov for dial-in/login information. To attend in person, contact barbarai@dor.wa.gov by March 26, 2024.

Date of Intended Adoption: April 19, 2024.

Submit Written Comments to: Michael Hwang, 6400 Linderson Way S.W., Tumwater, WA 98504, email MichaelHw@dor.wa.gov, 360-534-1575, by April 12, 2024.

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 substantive aspects of the excise tax on capital gains by supplying additional definitions and examples related to this excise tax.

Reasons Supporting Proposal: This rule will provide useful information for taxpayers on calculating the excise tax on capital gains.

Statutory Authority for Adoption: RCW 82.01.060, 82.32.300.

Statute Being Implemented: Chapter 82.87 RCW.

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 does not create any liability for taxes or fees, reporting requirements, recordkeeping requirements, or compliance requirements not already otherwise imposed by statute.

March 6, 2024
Brent Madison
Rules Coordinator

OTS-4743.8

NEW SECTION

WAC 458-20-301 Capital gains excise tax—Definitions, deductions, exemptions, and allocation of gains and losses. (1) **Introduction.** Beginning January 1, 2022, Washington law imposes an excise tax on individuals who sell or exchange long-term capital assets. See chapter 82.87 RCW (capital gains excise tax). This rule provides interpretive guidance related to the tax, including definitions of terms and explanations regarding the treatment of specific transactions. This rule contains examples that identify a number of facts, and then it states a conclusion. The examples 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) **Definitions and terms, and related information.**

(a) **Adjusted capital gain.** Adjusted capital gain means federal net long-term capital gain:

(i) Plus, any amount of long-term capital loss from a sale or exchange that is exempt from the capital gains excise tax, to the extent such loss was included in calculating federal net long-term capital gain;

(ii) Plus, any amount of long-term capital loss from a sale or exchange that is not allocated to Washington under RCW 82.87.100, to the extent such loss was included in calculating federal net long-term capital gain;

(iii) Plus, any amount of loss carryforward from a sale or exchange that is not allocated to Washington under RCW 82.87.100, to the extent such loss was included in calculating federal net long-term capital gain;

(iv) Less, any amount of long-term capital gain from a sale or exchange that is not allocated to Washington under RCW 82.87.100, to the extent such gain was included in calculating federal net long-term capital gain;

(v) Less, any amount of long-term capital gain from a sale or exchange that is exempt under chapter 82.87 RCW, to the extent such gain was included in calculating federal net long-term capital gain. See RCW 82.87.020; and

(vi) Plus, any amount of capital loss carryforward from a sale or exchange that occurred before January 1, 2022, to the extent such loss was included in calculating federal net long-term capital gain, and less any long-term capital gain from an installment sale that occurred before January 1, 2022, to the extent such gain was included in calculating federal net long-term capital gain. See subsection (3)(a) of this rule for additional information regarding the two adjustments described in this paragraph.

(b) **Another taxing jurisdiction.** Another taxing jurisdiction means a state of the United States other than the state of Washington, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any foreign country or political subdivision of a foreign country. See RCW 82.87.100. The United States is not "another taxing jurisdiction."

(c) **Domicile.** In general, domicile means a permanent place of abode, coupled with the intent to make the abode one's home. It is the place that you intend to return to even if you visit or temporarily reside elsewhere. Thus, actual presence in a location at any given time is not necessarily determinative of a person's domicile. An individual can have only one domicile at a time. A Washington domiciliary who intends to move at a future date is still considered domiciled in Washington. See subsection (6)(c) of this rule for more details.

(d) **Family.** Family means the same as "member of the family" in RCW 83.100.046. See RCW 82.87.070.

(e) **Federal net long-term capital gain.** Federal net long-term capital gain means the net long-term capital gain reportable for federal income tax purposes determined as if I.R.C. §§ 55 through 59, 1400Z-1, and 1400Z-2 did not exist. See RCW 82.87.020. This information is reported on Schedule D of the U.S. Individual Income Tax Return.

(f) **Grantor trust.** A grantor trust is any trust in which the grantor or another person is treated as the owner of any portion of the trust for federal income tax purposes under I.R.C. §§ 671-679. "Grantor trust" also includes any nongrantor trust where the grantor's transfer of assets to the trust is treated as an incomplete gift under I.R.C. § 2511 and accompanying regulations, to the extent that grantor's transfer of assets to the trust is treated as an incomplete gift. The grantor of a nongrantor trust must include any long-term capital gain or loss from the sale or exchange of a capital asset attributable to the grantor's gift to the trust, to the extent such gift is incomplete, in the calculation of that individual's adjusted capital gain, if such gain or loss is allocated to this state under RCW 82.87.100.

(g) **Intangible personal property.** Intangible personal property means all personal property other than tangible personal property. For example, software is intangible personal property.

(h) **Internal Revenue Code/I.R.C.** Internal Revenue Code or I.R.C. means Title 26 U.S.C., i.e., the United States Internal Revenue Code of 1986, as amended, as of July 25, 2021, or as of such subsequent date as noted in this rule. See RCW 82.87.020.

(i) **Long-term capital asset.** Long-term capital asset means a capital asset held for more than one year. See RCW 82.87.020.

(j) **Materially participated.** Materially participated means an individual was involved in the operation of a business on a basis that is regular, continuous, and substantial. Materially participated generally has the same meaning as the term "material participation," as defined in I.R.C. § 469 and related treasury regulations, to the extent not inconsistent with the qualified family-owned small business deduction provided in RCW 82.87.070.

(k) **Nongrantor trust.** A nongrantor trust is any trust other than a grantor trust.

(l) **Permanent place of abode; place of abode.** A place of abode means a fixed dwelling or home maintained by an individual for occupancy. Permanency of a place of abode is determined by whether the place of abode serves more than a temporary purpose. Occupancy of the dwelling or home, ownership status, nature, characteristics, use, names, or labels of a dwelling are considered, but are not conclusive as to determining the permanency of a place of abode. For example, a rental apartment that an individual lives in for the tax year is indicative of a permanent place of abode, while a camp or vacation home that is suitable and in fact used only for vacations is not indicative of a permanent place of abode.

(m) **Principally directed or managed within the state of Washington.** Principally directed or managed within the state of Washington means that an organization's activities are primarily directed, controlled, and coordinated in Washington. An office location in Washington alone does not establish that the organization is principally directed or managed in Washington. For example, a Washington location is insufficient for this purpose if the organization's activities are not primarily directed, controlled, and coordinated from the Washington location. Organizations may submit an affidavit to the department attesting that the organization is principally directed or managed in Washington. The affidavit is available at the department website, dor.wa.gov.

(n) **Qualified organization.** A qualified organization means an organization that is eligible to receive a charitable contribution as defined in I.R.C. § 170(c), and is principally directed or managed within the state of Washington. See RCW 82.87.080.

(o) **Qualifying interest.** Qualifying interest means an interest in a business that meets one of the following characteristics:

(i) An interest as a proprietor in a business carried on as a sole proprietorship;

(ii) An interest in a business if at least 50 percent of the business is owned, directly or indirectly, by any combination of the taxpayer or members of the taxpayer's family, or both; or

(iii) An interest in a business if at least 30 percent of the business is owned, directly or indirectly, by any combination of the taxpayer or members of the taxpayer's family, or both, and:

(A) At least 70 percent of the business is owned, directly or indirectly, by members of two families; or

(B) At least 90 percent of the business is owned, directly or indirectly, by members of three families.

(p) **Real estate.** Real estate means land and fixtures affixed to land, and also includes used mobile homes, used park model trailers, used floating homes, and improvements constructed upon leased land. See RCW 82.87.020.

(q) **Resident.**

(i) Resident generally includes any individual who is domiciled in Washington during the taxable year. However, the term does not include a Washington domiciliary if the domiciliary:

(A) Did not maintain a permanent place of abode in Washington at any time during the entire taxable year;

(B) Maintained a permanent place of abode outside of Washington during the entire taxable year; and

(C) Spent in the aggregate not more than 30 days of the taxable year in Washington. See RCW 82.87.020.

(ii) Resident also includes any individual not domiciled in Washington during the taxable year if the individual maintained a place of abode in Washington at any time during the taxable year and was physically present in Washington for more than 183 days during the taxable year. See RCW 82.87.020. A day, for purposes of this definition, means a calendar day or any portion of a calendar day.

(r) **Tangible personal property.** Tangible personal property means personal property that can be seen, weighed, measured, felt, or touched, but does not include steam, electricity, or electrical energy.

(s) **Taxpayer.** Taxpayer means an individual, i.e., a natural person, subject to the capital gains excise tax. In this rule, the taxpayer is also referred to as "you" and "your."

(t) **Washington capital gains.** Washington capital gains means an individual's adjusted capital gain, as modified in RCW 82.87.060, for each return filed under this chapter. See RCW 82.87.020 and subsection (5) of this rule for information on the deductions provided in RCW 82.87.060.

(3) **Tax imposed.**

(a) **The measure of tax; adjustments to federal net long-term capital gain.** The capital gains excise tax is imposed on the sale or exchange of long-term capital assets. The measure of the capital gains excise tax is Washington capital gains. Generally, Washington capital gains begins with the taxpayer's reportable federal net long-term capital gain, and this amount is then adjusted by certain statutory additions and subtractions to reach adjusted capital gain. For example, these adjustments remove exempt transactions or those not allocated to Washington from the taxable measure. Statutory deductions further modify adjusted capital gain to reach the taxpayer's Washington capital gains figure.

If your Washington capital gains are less than zero for a taxable year, no tax is due under this section, and you are not allowed to carryover this amount for use in the calculation of your adjusted capital gain for any other taxable year.

To the extent that a loss carryforward is included in the calculation of your federal net long-term capital gain and that loss carryforward is directly attributable to losses from sales or exchanges allocated to this state under RCW 82.87.100, the loss carryforward is included in the calculation of your adjusted capital gain. However, you may not include any losses carried back for federal income tax purposes in the calculation of your adjusted capital gain for any taxable year. See RCW 82.87.040.

(i) **The effective date of the tax.** The capital gains excise tax is imposed on the sale or exchange of capital assets on and after January 1, 2022. Sales or exchanges occurring before the January 1, 2022, effective date of the tax, are not part of the taxable measure of the capital gains excise tax. There are at least two situations affected by this timing issue:

(A) Loss carryforwards prior to 2022. Although the measure of the capital gains excise tax is federal net long-term capital gain, you must add back any loss carryforwards from sales or exchanges of long-term capital assets that occurred prior to January 1, 2022, in calculating adjusted capital gain to the extent such loss was included in calculating federal net long-term capital gain because any pre-2022 loss arose from a sale or exchange prior to the effective date of the capital gains excise tax. See subsection (2)(a) of this rule for the definition of adjusted capital gain.

(B) Installment sales. Long-term capital gain recognized from an installment sale, as defined in I.R.C. § 453, is not subject to capital gains excise tax if the sale occurred before January 1, 2022, even if some installment payments occur on or after January 1, 2022. You should remove any gain recognized from installment sales that occurred prior to January 1, 2022, in calculating adjusted capital gain to the extent such gain was included in calculating federal net long-term capital gain. See subsection (2)(a) of this rule for the definition of adjusted capital gain. If the installment sale occurred on or after January 1, 2022, you must include the long-term capital gain in the measure of the Washington capital gains excise tax in the same manner as the gain is reportable for federal tax purposes.

(ii) **Sale or exchange of long-term capital assets.** The imposition of the capital gains excise tax is conditioned on the sale or exchange of a long-term capital asset. In other words, if you sell or exchange a capital asset resulting in a long-term capital gain or loss, that gain or loss is included in calculating your adjusted capital gain. Alternatively, if you have a long-term capital gain or loss that did not arise from a sale or exchange, then that gain or loss is not included in calculating your adjusted capital gain.

Example 1: Gifts.

Facts: In 2024, Jane received an old baseball card worth $30,000 from her brother, Jim, as a gift. Jim has no reportable federal net long-term capital gain from this transaction or from any other source.

Result: Because the transaction results in no federal long-term capital gain, Jim has no capital gains excise tax liability from the gift.

Example 2: Expatriation.

Facts: In 2024, Zander properly had federal net long-term capital gain in the amount of $500,000. A portion, $100,000, is long-term capital gain recognized under I.R.C. § 877A(a) because Zander is expatriating.

Result: Long-term capital gain is recognized under I.R.C. § 877A(a) as a result of a deemed sale. Because $100,000 of Zander's gain is not the result of a sale or exchange of a capital asset, that portion is not included in Zander's measure of Washington capital gains. He should subtract $100,000 from his federal net long-term capital gain when calculating his Washington capital gains.

Example 3: Maturity of bonds.

Facts: In 2024, Zora had federal net long-term capital gain in the amount of $500,000. A portion, $100,000, is long-term capital gain recognized under I.R.C. § 1271 upon the retirement of bonds Zora had purchased at discount.

Result: Upon the retirement of the bonds, Zora receives cash and no longer holds the capital assets (i.e., the bonds). These circumstances indicate the transaction is an exchange for purposes of the capital gains excise tax, and Zora should include the long-term capital gain recognized from the bonds in her Washington capital gains amount.

Example 4: Excess partnership distribution.

Facts: In 2024, Zane had federal net long-term capital gain in the amount of $500,000. A portion, $100,000, is long-term capital gain recognized under I.R.C. § 731 because the partnership in which Zane is a partner distributed cash to him in an amount that exceeded Zane's basis in the partnership.

Result: The long-term capital gain that Zane recognizes from the excess distribution is not due to a sale or exchange of a capital asset. Therefore, Zane should subtract $100,000 from his federal net long-term capital gain when calculating his Washington capital gains.

Example 5: Section 1256 contracts.

Facts: In 2023, Mavis, a Washington domiciliary, recognized both gains and losses from various Section 1256 contracts, as defined in I.R.C. § 1256. Mavis recognized a $300 gain from the sale of an 18-month futures contract that she held for one year and three months, a $400 loss from the sale of a three-month nonequity option contract that she held for one month, and a $100 gain from a 24-month foreign currency contract that she continues to hold, but was deemed sold at the end of the year for federal tax purposes. Under I.R.C. § 1256, 60 percent of the gain or loss from Section 1256 contracts is treated as long-term capital gain or loss, and 40 percent is treated as short-term capital gain or loss. For federal tax purposes, Mavis had $0 in net capital gain from these contracts for 2023.

Result: Although Mavis had $0 in federal net long-term capital gain from the Section 1256 contracts in 2023, only long-term capital gains and losses from Section 1256 contracts that were held for more than one year and were sold are included in calculating an individual's Washington capital gains excise tax. Here, Mavis sold or exchanged only one contract that she held for more than one year, the 18-month contract. Therefore, Mavis should calculate her Washington capital gains from her Section 1256 contracts by including only the $300 in long-term capital gain she recognized from her sale of the 18-month futures contract. The $240 long-term capital loss she recognized for federal tax purposes on the three-month contract and the $60 long-term capital gain she recognized on the 24-month contract are not part of her Washington capital gains.

(iii) **Other examples on the measure of tax.**

Example 6: Capital gain invested in qualified opportunity fund.

Facts: In 2023, Joseph, a Washington domiciliary, sold stock he had held for two years for $2,000,000. His basis in the stock was $700,000. He invests in the same year, $1,300,000 in a qualified opportunity fund, as defined in I.R.C. § 1400Z-2, and elects to defer federal taxation of the gain from the sale of his stock as permitted under I.R.C. § 1400Z-2. Joseph sells no other capital assets in 2023. As a result of the deferral, Joseph recognizes in 2023 $0 net long-term capital gain for federal tax purposes.

Result: An individual's Washington capital gains is based on their federal net long-term capital gain, which is defined as the net long-term capital gain reportable for federal income tax purposes determined as if Title 26 U.S.C. Secs. 55 through 59, 1400Z-1, and 1400Z-2 of the Internal Revenue Code did not exist. Because the definition of federal net long-term capital gain excludes Section 1400Z-2 of the Internal Revenue Code, Joseph must include the $1,300,000 in long-term capital gain from his 2023 sale of stock in calculating his 2023 Washington capital gains.

Example 7: Sale of qualified opportunity fund.

Facts: Same facts as Example 6, and Joseph sells his investment in the qualified opportunity fund in 2025 for $1,700,000. Under the basis and gain recognition rules in I.R.C. § 1400Z-2, Joseph must recognize $1,300,000 in long-term capital gain on the sale of his interest in the qualified opportunity fund for federal tax purposes.

Result: The definition of federal net long-term capital gain for purposes of the Washington capital gains excise tax excludes Section 1400Z-2 of the Internal Revenue Code. Therefore, Joseph should ignore I.R.C. § 1400Z-2 when calculating the gain from the sale of his qualified opportunity fund investment for purposes of the Washington capital gains excise tax, and, in this case, calculate his gain or loss by applying I.R.C. §§ 1001, 1011, and 1012.

Example 8: Section 1244 stock loss.

Facts: In 2023, David, who is domiciled in Washington, sold stock he had held for several years. Some of the stock sold by David was Section 1244 stock, as defined under I.R.C. § 1244(c). The sale of the Section 1244 stock resulted in a $50,000 loss, which David properly reported on his 2023 tax return as an ordinary loss. David's other stock sales in 2023 resulted in a net long-term capital gain of $1,300,000 and a net short-term capital loss of $20,000. David had no other capital gains or losses.

Result: Neither the $50,000 ordinary loss nor the $20,000 short-term capital loss David reported on his 2023 federal tax return are included in his federal net long-term capital gain. As a result, neither loss amount is included in calculating David's Washington capital gains. David's 2023 Washington capital gains amount is his federal net long-term capital gain, $1,300,000, subject to the exemptions and deductions discussed in subsections (4) and (5) of this rule.

Example 9: Section 1061 applicable partnership interests.

Facts: Marcy owns interests in partnerships that are "applicable partnership interests" under I.R.C § 1061. Marcy is a Washington domiciliary. In 2023, she reports on her federal tax return $1,000,000 in capital gain passed through from her partnerships, all from the sale of intangible long-term capital assets. A portion of this capital gain, $200,000, is recharacterized as short-term capital gain under I.R.C. § 1061. She reports the remainder, $800,000, as long-term capital gain. Marcy has no other capital gain or losses in 2023.

Result: The $200,000 in capital gain that is recharacterized as short-term capital gain under I.R.C. § 1061 is not part of Marcy's net long-term capital gain reportable for federal income tax purposes. Therefore, Marcy's 2023 Washington capital gains amount is $800,000, subject to the exemptions and deductions discussed in subsections (4) and (5) of this rule.

Example 10: Loss carried forward from a prior year.

Facts: In 2023, John incurs a $1,003,000 long-term capital loss from a sale of stock while John was domiciled in Washington. John does not have any capital gains against which he can apply the loss. Under I.R.C. § 1211, $3,000 of the loss is applied against ordinary income that John earned in 2023. Therefore, $1,000,000 of the loss is carried forward to 2024 under I.R.C. § 1212. In 2024, John incurs a $4,000,000 long-term capital gain from sales of stock while John continues to be domiciled in Washington. On John's federal return, John applies the $1,000,000 loss from 2023 and reports a federal net long-term capital gain of $3,000,000 for 2024.

Result: To calculate John's 2024 Washington capital gains, the starting point is John's federal net long-term capital gain of $3,000,000. None of the adjustments in RCW 82.87.020(1) apply in determining John's adjusted capital gain. Therefore, John's 2024 Washington capital gains amount is $3,000,000, subject to the exemptions and deductions discussed in subsections (4) and (5) of this rule.

Example 11: Out-of-state loss carried forward from a prior year.

Facts: Same facts as Example 10, except John incurs a net $1,003,000 long-term capital loss from a sale of stock while John was domiciled in Oregon, and John becomes domiciled in Washington in 2024.

Result: To calculate John's 2024 Washington capital gains, the starting point is John's federal net long-term capital gain of $3,000,000. RCW 82.87.020 (1)(c) instructs that the $1,000,000 loss carryforward must be added back to the $3,000,000 federal net long-term capital gain amount because all $1,000,000 of the loss was from a sale or exchange that was not allocated to Washington. Therefore, John's 2024 Washington capital gains amount is $4,000,000, subject to the exemptions and deductions discussed in subsections (4) and (5) of this rule.

Example 12: Short-term capital losses.

Facts: In 2023, Jason, a Washington domiciliary, realizes a $403,000 short-term capital loss from sales of securities, and a

$325,000 net long-term capital gain from a sale of investment property. That year, he also earns $125,000 in other income. For federal tax purposes, $3,000 of the short-term capital loss is applied against Jason's other income and $325,000 of the short-term capital loss is applied against Jason's long-term capital gain. The remaining $75,000 net short-term capital loss is carried forward to 2024.

Result: Jason's 2023 Washington capital gains amount is his federal net long-term capital gain, $325,000, subject to the exemptions and deductions discussed in subsections (4) and (5) of this rule.

Example 13: Short-term loss carried forward.

Facts: Same facts as Example 12, and in 2024, Jason realizes long-term capital gain totaling $1,000,000, and short-term capital gain totaling $200,000, all from sales of securities. For federal tax purposes, the $75,000 short-term capital loss carried forward from 2023 is applied against Jason's 2024 $200,000 net short-term capital gain.

Result: Jason's 2024 Washington capital gains amount is $1,000,000, subject to the exemptions and deductions discussed in subsections (4) and (5) of this rule.

(b) **Beneficial ownership; pass-through entities.** The capital gains excise tax applies to the sale or exchange of long-term capital assets owned by individuals. Ownership includes both legal and beneficial ownership. An individual is considered to be a beneficial owner of long-term capital assets held by any pass-through or disregarded entity in which the individual holds an ownership interest, to the extent of the individual's ownership interest in the entity as reported for federal income tax purposes. See RCW 82.87.040. Accordingly, you must include both gains from the sale or exchange of capital assets of which you are the legal owner and gains passed through to you from the sale or exchange of capital assets of which you are a beneficial owner. Examples of pass-through entities for federal tax purposes include partnerships, limited liability companies, S corporations, and grantor trusts. See RCW 82.87.040. The department does not consider estates, or trusts other than grantor trusts, to be pass-through entities. However, beneficiaries of estates and nongrantor trusts may nevertheless be subject to capital gains excise tax on distributions of capital gains received from estates and nongrantor trusts.

Example 14: Mutual fund.

Facts: Jane is domiciled in Washington and an investor in a mutual fund. A mutual fund is formed as a regulated investment company, a type of pass-through entity for federal income tax purposes. In 2024, the fund earns long-term capital gain from the sale of capital assets held by the fund. Some of the capital gain is distributed to the fund's shareholders, and some of the gain is retained in the fund and reported as undistributed capital gain.

Result: Jane is liable for capital gains excise tax on her Washington capital gains arising from the sale of the fund's long-term capital assets to the extent of her ownership interest in the fund as reported for federal income tax purposes, including her share of the fund's undistributed capital gain, subject to the exemptions and deductions discussed in subsections (4) and (5) of this rule.

Example 15: S corporation.

Facts: Jack is domiciled in Washington. He is a 50 percent shareholder of an S corporation. The S corporation is a long-time shareholder of a C corporation. The S corporation sells the C corporation shares, resulting in long-term capital gain, 50 percent of which is passed through to Jack for federal income tax purposes.

Result: Jack is a beneficial owner of the S corporation's assets. Jack must include his 50 percent share of the long-term capital gain arising from the S corporation's sale of stock in calculating his Washington capital gains.

Example 16: Tiered partnership - Limited liability company.

Facts: Juan is domiciled in Washington. Juan is a 50 percent owner of a partnership. The partnership is a 50 percent owner of an LLC. The LLC sells an intangible asset that it has owned for two years, which results in long-term capital gain. As the owner of the partnership, 25 percent of the long-term capital gain from the LLC's sale of the intangible asset is passed through to Juan for federal income tax purposes.

Result: Because Juan is an owner of a pass-through entity, the partnership, and the partnership is an owner of another pass-through entity, the LLC, Juan is a beneficial owner of the LLC's assets. Therefore, Juan must include in calculating his Washington capital gains, the long-term capital gain passed through to him arising from the LLC's sale of the intangible asset.

(4) **Exemptions.** You may treat certain types of sales or exchanges as exempt from the capital gains excise tax. See RCW 82.87.050. These exemptions are subject to the following guidelines.

(a) **Real estate.** Generally, long-term capital gains from sales or exchanges of real estate are not subject to capital gains excise tax. This exemption applies to all real estate transferred by deed, real estate contract, judgment, or other lawful instruments that transfer title to real property and are filed as a public record with the counties where real property is located.

Example 17: Sale of real estate by an individual.

Facts: Pamela is a Washington domiciliary and owns investment real property in Western Washington. In 2025, a real estate developer offers to buy the real property. Pamela accepts the developer's offer and completes the sale the same year. The sale results in a $10,000,000 long-term capital gain, which Pamela reports for federal income tax purposes. Pamela's only other transaction in 2025 involving long-term capital assets is a sale of some stock that resulted in $300,000 in long-term capital gain. Her total federal net long-term capital gain in 2025 is $10,300,000.

Result: Pamela is exempt from Washington capital gains excise tax on the $10,000,000 long-term capital gain arising from the sale of the real property. In calculating adjusted capital gain for 2025, Pamela should subtract the $10,000,000 from her federal net long-term capital gain as an amount of long-term capital gain from a sale or exchange that is exempt under chapter 82.87 RCW. Pamela's 2025 Washington capital gains equals $300,000, subject to the exemptions and deductions discussed in subsections (4) and (5) of this rule.

Example 18: Sale of real estate by pass-through entity.

Facts: Paul and Pierre each own 50 percent of Invesco LLC. Invesco owns 100 percent of two other LLCs, PropertyOne LLC and PropertyTwo LLC. PropertyOne's only asset is investment real property located in Eastern Washington. In 2024, PropertyOne sells the investment property, resulting in $6,000,000 of long-term capital gain. For federal tax purposes, Paul and Pierre each recognize $3,000,000 in long-term capital gain from their distributive shares of the capital gain passed-through from PropertyOne.

Result: PropertyOne's sale of the investment property is exempt from capital gains excise tax. In calculating their Washington capital gains, Paul and Pierre should each subtract the $3,000,000 from their federal net long-term capital gain as an amount of long-term capital gain from a sale or exchange that is exempt under chapter 82.87 RCW.

(b) **Sales of entities owning real estate.** The sale of an interest in a privately held entity is exempt from the capital gains excise tax to the extent the long-term gain or loss from the sale is directly attributable to real estate owned directly by the entity.

(i) A "privately held entity" for this purpose means an entity that is not traded through public means. For example, a privately held entity does not include a corporation traded on a public exchange.

(ii) "Owned directly" means the privately held entity in which the individual has an interest legally owns (holds legal title to) the real estate.

(iii) The value of this exemption is equal to the fair market value of the real estate owned directly by the privately held entity less its basis at the time that the sale or exchange of the individual's interest occurs, multiplied by the percentage of the ownership interest in the entity that is sold or exchanged by the individual. The following are not considered in the calculation of the exemption amount:

(A) Any amount that I.R.C. § 751 treats as an amount realized from the sale or exchange of property other than a capital asset; and

(B) Real estate not owned directly by the entity in which an individual is selling or exchanging the individual's interest.

(iv) The fair market value of real estate may be established by a fair market value appraisal issued by a state-licensed real estate appraiser or an allocation of assets by the seller and the buyer made consistent with the principles required for an allocation under I.R.C. § 1060, as amended, and related treasury regulations. However, the department is not bound by the parties' agreement as to the allocation of assets, allocation of consideration, or fair market value, if such allocations or fair market value do not reflect the fair market value of the real estate. The assessed value of the real estate for property tax purposes may also be used to determine the fair market value of the real estate if the assessed value is current as of the date of the sale or exchange of the ownership interest in the entity owning the real estate and the department determines that this method is reasonable under the circumstances. In no case may the exemption value under (b) of this subsection exceed the individual's long-term capital gain from the sale or exchange of the interest in the entity for which the individual is claiming this exemption.

Example 19: Sale of private entity directly and indirectly owning real estate.

Facts: Ken, who is domiciled in Washington, owns 100 percent of Holding Company LLC. Holding Company LLC owns three assets: A 100 percent interest in First Avenue Tower LLC, a 100 percent interest in Second Avenue Tower LLC., and 100 percent of Third Avenue Tower, a commercial building. All of the entities are privately held entities. First Avenue Tower LLC owns one asset: First Avenue Tower, a commercial building with a fair market value of $4,000,000, and a basis of $1,000,000. Second Avenue Tower LLC also owns only one asset, a commercial building called Second Avenue Tower. Second Avenue Tower has a fair market value of $8,000,000, and a basis of $5,000,000. Third Avenue Tower has a fair market value of $5,000,000, and a basis of $2,000,000.

Real estate	FMV	Basis
First Avenue Tower	$4,000,000	$1,000,000
Second Avenue Tower	$8,000,000	$5,000,000
Third Avenue Tower	$5,000,000	$2,000,000

Ken sells his entire interest in Holding Company LLC for $17,000,000. His gain from the sale is a $9,000,000 long-term capital gain.

Result: A portion of the $9,000,000 gain Ken recognizes from the sale of Holding Company LLC may qualify for exemption. Ken's long-term capital gain from the sale of his Holding Company LLC interest is ineligible for the exemption with respect to First Avenue Tower and Second Avenue Tower because Holding Company LLC does not directly own those properties. However, Holding Company LLC owns Third Avenue Tower directly. Therefore, $3,000,000 of Ken's gain from the sale of Holding Company LLC is exempt. This amount is the difference between the fair market value of Third Avenue Tower and the basis of that property.

Example 20: Sale of private entity directly and indirectly owning real estate.

Facts: Same general facts as Example 19, except Holding Company LLC liquidates First Avenue Tower LLC prior to Ken's sale of Holding Company LLC. As a result of the liquidation, at the time of Ken's sale of his Holding Company interest, Holding Company LLC directly owns the commercial building previously held by First Avenue Tower LLC, as well as Third Avenue Tower.

Result: A portion of the $9,000,000 gain Ken recognizes from the sale of Holding Company LLC may qualify for exemption. Specifically, the value of the exemption equals $6,000,000, which is the $4,000,000 fair market value of First Avenue Tower minus its $1,000,000 basis, plus the $5,000,000 fair market value of Third Avenue Tower minus its $2,000,000 basis, multiplied by Ken's 100 percent ownership interest in Holding Company LLC.

Example 21: Sale of private entity directly owning a partial interest in real estate.

Facts: Mitch is a Washington domiciliary who owns 100 percent of Mitch Holdings LLC. Mitch Holdings LLC owns one asset, a 40 percent interest in an investment property. Mitch recently decided to divest from the property and did so by selling his entire interest in Mitch Holdings LLC to another person. The assessed value of the investment property is $2,300,000.

Result: Mitch Holdings LLC is a privately held entity. Mitch's sale of Mitch Holdings LLC is exempt from the capital gains excise tax to the extent the long-term gain or loss from the sale is directly attributable to real estate owned directly by Mitch Holdings LLC, in this case, the investment property. The value of the exemption for Mitch is equal to the fair market value of Mitch Holdings LLC's interest in the investment property, less its basis. Mitch should obtain an appraisal to determine the fair market value of Mitch Holdings LLC's interest in the property. See RCW 82.87.050. While the assessed value of real estate may be used in some circumstances to determine fair market value, use of assessed value, or a percentage of the assessed value, is not a reasonable method for determining the fair market value of a partial interest in real estate.

Example 22: Sale of private entity owning real estate; exemption limitation.

Facts: Jesse, a Washington domiciliary, owns 100 percent of Property Co., an LLC. Property Co. owns three assets: A 100 percent interest in Property One LLC, a 100 percent interest in Property Two LLC, and a piece of real estate, Property 3. Property One LLC's only asset is real estate, Property 1, which has a fair market value of $5,000,000, and a basis of $2,000,000. Property Two LLC's only asset is a piece of depressed real estate, Property 2, which has a fair market value of $2,000,000, and a basis of $10,000,000. Property 3 has a fair market value of $12,000,000, and a basis of $5,000,000.

	FMV	Basis
Property 1	$5,000,000	$2,000,000
Property 2	$2,000,000	$10,000,000
Property 3	$12,000,000	$5,000,000

Jesse sells her entire interest in Property Co. for $19,000,000. Jesse's basis in Property Co. is $17,000,000. The sale results in a $2,000,000 long-term capital gain for Jesse.

Result: The value of this exemption is equal to the fair market value of the real estate owned directly by the privately held entity, less its basis. However, the exemption value may not exceed the individual's long-term capital gain or loss from the sale or exchange of the interest in the entity. Here, Property 3 is the only real estate owned directly by Property Co. Its fair market value minus its basis is $7,000,000. However, Jesse's gain from the sale of Property Co. is only $2,000,000. Therefore, the value of the exemption from Jesse's sale of Property Co. is limited to $2,000,000.

(c) **Retirement accounts.** Sales or exchanges of assets held under retirement savings accounts or retirement savings vehicles that are exempt from federal income tax are also generally exempt from capital gains excise tax. Exempt retirement accounts include the following:

(i) Retirement savings accounts under I.R.C. § 401(k);

(ii) Tax-sheltered annuities or custodial accounts described in I.R.C. § 403(b);

(iii) Deferred compensation plans under I.R.C. § 457(b);

(iv) Individual retirement accounts or individual retirement annuities described in I.R.C. § 408;

(v) Roth individual retirement accounts described in I.R.C. § 408A;

(vi) Employee defined contribution programs, employee defined benefit plans; and

(vii) Retirement savings vehicles or accounts similar to those described above, such as exempt foreign retirement accounts.

(d) **Assets subject to condemnation.** Sales or exchange of assets pursuant to, or under imminent threat of condemnation proceedings by the United States, the state or any of its political subdivisions, or a municipal corporation, are exempt from capital gains excise tax.

(e) **Certain livestock.** Sales or exchanges of cattle, horses, or breeding livestock are exempt if, for the taxable year of the sale or exchange, more than 50 percent of the taxpayer's gross income for the taxable year, including from the sale or exchange of capital assets, is from farming or ranching.

(f) **Depreciable property.** Sales or exchanges of property that is depreciable under I.R.C. § 167(a)(1) or that qualifies for expensing under I.R.C. § 179 is exempt from capital gains excise tax. Intangibles amortizable under I.R.C. § 197 do not qualify for this exemption.

Example 23: Nondepreciable intangible property.

Facts: Bob, a Washington domiciliary, sells in 2023 all his assets in a Burger Bob franchise store that he acquired in 2018. The sale results in long-term capital gain. A portion of the long-term capital gain was attributable to Bob's sale of goodwill in the store. Bob claims an exemption from capital gains excise tax on the portion of the long-term capital gain that is attributable to goodwill.

Result: Bob's long-term capital gain from the sale of the goodwill is not exempt from capital gains excise tax because goodwill is an intangible amortizable under I.R.C. § 197 rather than property depreciable under I.R.C. § 167(a)(1) or property that qualifies for expensing under § 179.

(g) **Timber and timberland.** Sales of timber as defined in RCW 82.87.050, and timberland, as well as capital gains received as dividends and distributions from real estate investment trusts derived from gains from the sale or exchange of timber and timberland, are exempt from capital gains excise tax. Cutting or disposal of timber qualifying for capital gains treatment under I.R.C. § 631(a) or (b) is also considered a sale or exchange that is exempt from capital gains excise tax.

(h) **Commercial fishing privileges.** Sales or exchanges of commercial fishing privileges, as defined in RCW 82.87.050, are exempt from capital gains excise tax.

(i) **Goodwill in an auto dealership.** Sales or exchanges of goodwill received from the sale of an auto dealership licensed under chapter 46.70 RCW whose activities are subject to chapter 46.96 RCW are exempt from capital gains excise tax. However, long-term capital gain from sales or exchanges of goodwill in other types of businesses are not exempt from capital gains excise tax.

(5) **Deductions.** To obtain your Washington capital gains, you may deduct certain amounts from the measure of your adjusted capital gain, subject to the following guidelines. RCW 82.87.060.

(a) **Standard deduction.**

(i) Individuals other than spouses or state-registered domestic partners are entitled to deduct $250,000 from their Washington capital gains.

(ii) Spouses and state-registered domestic partners are limited to a total standard deduction of $250,000, regardless of whether they file joint or separate returns. In the case of spouses or domestic partners filing separate returns, the deduction may be split in whatever manner the spouses or partners choose, so long as the total claimed deduction does not exceed $250,000.

(b) **Charitable donation deduction.** A taxpayer may take a deduction from their Washington capital gains for certain charitable donations to one or more qualified organizations during a tax year. See subsection (2) of this rule for "qualified organization" definition.

(i) **Deduction amount; limitation.** The charitable donation deduction equals the difference between the taxpayer's total qualifying donations minus $250,000. The maximum charitable donation deduction in a year is $100,000 per tax return, regardless of the taxpayer's filing status. Thus, in the case of one joint tax return, the maximum charitable donation deduction is $100,000 although the return is filed by two individuals.

(ii) **Donor-advised funds; indirect donations through intermediaries.** Generally, a donor-advised fund is a separately identified account that is maintained and operated by a nonprofit organization, and each account is composed of donations that are made by individual donors. Although the nonprofit organization has legal control over it, individual donors maintain advisory privileges with respect to the distribution of funds and management of the account's assets. If you donate to a donor-advised fund or a similar intermediary charitable vehicle, that intermediary, or in case of a donor advised fund, the organization that owns or controls the fund, must qualify as a qualified organization under RCW 82.87.080. The organization to which you make the donation, and not the organization where the donation ends up, determines whether you donated to a qualified organization.

Example 24: Qualifying charitable donations by a couple.

Facts: Chris and Hannah are a married couple. They file a joint return for federal tax purposes, and therefore also file a joint capital gains excise tax return. See RCW 82.87.120. However, they maintain some separate funds consisting of separate property (rather than community property). In 2024, each spouse made charitable donations to qualified organizations using their separate funds. Chris made donations totaling $290,000, and Hannah made donations totaling $400,000.

Result: The maximum charitable donation deduction in a year is $100,000 per tax return. Thus, the total charitable donation deduction the couple can take on their joint capital gains excise tax return is $100,000, even though the sum of the spouses' donations exceeded $250,000 by more than $100,000.

Example 25: Nonqualifying charitable donation.

Facts: Jimmy donates $350,000 to the Global Wildlife Fund (GWF) every year. GWF is an international nonprofit organization that aims to conserve endangered species. Its global headquarters is in Sweden. GWF has a U.S. headquarters in Washington, D.C., and has no presence in Washington state. Jimmy claims a $100,000 charitable donation deduction on his capital gains excise tax return.

Result: The facts indicate that GWF is not principally directed or managed within Washington state. Therefore, Jimmy is not eligible for the charitable donation deduction for his donation to GWF, because GWF is not a qualified organization under RCW 82.87.080.

(c) **Qualified family-owned small business deduction.** You may deduct the amount of adjusted capital gain derived in the taxable year from your sale or transfer of a qualified family-owned small business, subject to all the following requirements. RCW 82.87.070.

(i) The sale or transfer must be a sale of substantially all the business's assets or a transfer of substantially all of your interest in the business. A transfer of substantially all the business's assets, means a sale of at least 90 percent of the business's real property and tangible and intangible personal property, measured by fair market value. A sale of substantially all of your interest in the business, means a transfer of at least 90 percent of your interest in the business.

(ii) You must have held a qualifying interest in the qualified family-owned small business for at least five years immediately preceding the sale or transfer. A mere change in form of the business, i.e., where no change in beneficial ownership of the business has occurred, including no change in the proportion of beneficial ownership in the business, does not interrupt this required holding period.

(iii) You, or your family, or both, must have materially participated in operating the business for at least five of the 10 years immediately preceding the sale or transfer, unless the sale or transfer was to a member of your family. A mere change in form of the business, i.e., where no change in beneficial ownership of the business has occurred, including no change in the proportion of beneficial ownership in the business, does not interrupt this required participation period.

(iv) The business's worldwide gross revenue cannot have exceeded $10,000,000 in the 12-month period immediately preceding the sale or transfer.

(6) **Allocation of long-term capital gains and losses.** Allocation is the method for determining which long-term capital gains and losses to include in computing a taxpayer's Washington capital gains.

(a) **Tangible personal property.** You must allocate to Washington long-term capital gain or loss from a sale of tangible personal property in two situations:

(i) The tangible personal property was located in Washington at the time of the sale or exchange, i.e., the tangible personal property was physically present in Washington at the time the sale or exchange occurred; or

(ii) The tangible personal property was not located in Washington at the time of the sale or exchange, but the transaction had each of the following characteristics:

(A) The property was located in Washington at any time during the year in which the sale or exchange occurred or in the immediately preceding year;

(B) The taxpayer was a Washington resident at the time the sale or exchange occurred; and

(C) The taxpayer was not subject to the payment of an income or excise tax legally imposed on the long-term capital gain by another taxing jurisdiction. If the sale generated a loss, this element is met if the loss is not included in the taxpayer's income or excise tax base in another taxing jurisdiction. RCW 82.87.100.

Example 26: Allocation of gain from tangible personal property.

Facts: Michael is domiciled in Washington. His home is in Seattle, and he resides there year-round. In October 2024, Michael decides to sell a coin collection he inherited two years ago. In December, Michael brings the coins to Nevada, which does not have an income tax and does not impose excise taxes on occasional sales. While in Nevada, Michael sells the coin collection and the sale results in a $100,000 long-term capital gain.

Result: Michael's $100,000 long-term capital gain from the sale is allocated to Washington for purposes of the capital gains excise tax. Although he sold the coins in Nevada, they were located in Washington during the year in which the sale occurred, Michael was a Washington resident at the time the sale occurred, and Michael was not subject to an income or excise tax on the sale of the coins in another taxing jurisdiction.

(b) **Intangible personal property.** You must allocate to Washington long-term capital gain or loss from a sale or exchange of intangible personal property if you were domiciled in Washington at the time the sale or exchange occurred. RCW 82.87.100.

(c) **Determinations of domicile.**

(i) Determination of intent, burden of proof. An intention to make a place of abode one's domicile is determined by facts and circumstances on a case-by-case basis. The department will review the factors and some may be given more weight than others depending on the facts and circumstances. The following is a nonexclusive list of factors the department will consider in evaluating an individual's domicile:

• Length of time spent in a location;
• Expressed intent;
• Place of business, profession, or employment;
• Location of bank accounts;
• Residence and address for federal income and state tax purposes;
• Sites of personal and real property owned by the individual;
• State of motor vehicle and other personal property registration;
• State of motor vehicle driver's license;
• Location of schools attended by children;
• State of voter registration;
• Location of professional or business licenses;
• Payment of in-state tuition;
• Location from where financial transactions originate;
• Claiming of residence in a state for purposes of obtaining a hunting or fishing license, eligibility to hold public office, eligibility for obtaining a property tax benefit (such as a homestead exemption), or for judicial actions;
• Mailing address.

Individuals may submit to the department a request for a ruling on where the department considers individuals to be domiciled for purposes of this tax.

(ii) Continuation and change of domicile. Your domicile, once established, is presumed to continue. Therefore, if you have been domiciled in Washington, you will have the burden of proving your domicile has changed to a location outside of Washington. To establish a new domicile, you must be physically present at the new place of intended domicile and have an intention to make that new place your permanent home. This means that, for instance, selling your former home or acquiring a new one is not conclusive in establishing domicile.

(iii) Domicile of spouses, state-registered domestic partners, children. The department will presume that the domicile of spouses or state-registered domestic partners are the same. The department will also presume that a child's domicile is the same as the domicile of the child's parents until the child is no longer dependent and establishes his or her own separate domicile. If the parents have separate domiciles, the department will presume that the domicile of the child is the domicile of the parent with whom the child spends more time in the tax year.

(iv) Exceptions. Federal law may apply to service members in determination of domicile. Generally, under Title 50 U.S.C. § 571 (residence for tax purposes under the Servicemembers' Civil Relief Act), a member of the armed forces does not acquire a new domicile solely because that individual was stationed elsewhere during a period of active duty.

(d) **Credit for taxes paid to other taxing jurisdictions.** Taxpayers may be entitled to a credit against capital gains excise tax equal to the amount of any legally imposed income or excise tax paid by the taxpayer to another taxing jurisdiction on capital gains derived from capital assets within the other taxing jurisdiction. See RCW 82.87.100. In no case may the credit under this subsection (c) exceed the individual's capital gains excise tax liability on the capital assets for the tax year in which the individual claims this credit. Entitlement to this credit requires the following:

(i) Another taxing jurisdiction legally imposed an income or excise tax on capital gain included in the taxpayer's Washington capital gains;

(ii) The taxpayer in fact paid the tax imposed by the other taxing jurisdiction before the taxpayer filed their Washington capital gains excise tax return on which the credit is claimed; and

(iii) The gain taxed by the other jurisdiction arose from the sale or exchange of a capital asset within the other taxing jurisdiction. For this purpose, the department will presume that long-term capital gain from sales or exchanges of intangible personal property are within the other taxing jurisdiction if the other taxing jurisdiction legally imposed tax on the long-term capital gain derived from the sale or exchange of the intangible personal property.

Example 27: Allocation of gain from intangible property and credit for other taxes paid.

Facts: Julie is a Washington domiciliary and owns a second home in New York. During 2025, she resided in New York for eight months and in Washington the other four months. Julie is a casual investor. In 2025, Julie sold her investment in cryptocurrency to online buyers. The sale generated long-term capital gain for Julie. Under New York law, Julie is treated as a statutory resident even though she was domiciled in Washington. As a statutory resident, Julie is required to remit to New York income tax on the income she earned from the sale of the cryptocurrency. Julie pays the New York tax and files a Washington capital gains excise tax return, claiming a credit for the income tax paid to New York on the sale of the cryptocurrency.

Result: Because Julie was domiciled in Washington at the time the sale or exchange occurred, the gain from her sale is allocated to Washington. However, because New York legally imposed income tax on Julie's sale of cryptocurrency and Julie remitted income tax on the sale to New York, Julie is entitled to a credit against Washington capital gains excise tax equal to the New York tax Julie paid on the transaction.

(e) **Allocation and sourcing of gains or losses from pass-through entities.** The allocation method for gains and losses is the same whether you owned the property directly or indirectly through a pass-through or disregarded entity.

Example 28: Allocation of passed through gain from intangible property.

Facts: Jack is domiciled in Washington. He is a 50 percent shareholder of Invest Corp., an S corporation. Invest Corp. is a long-time shareholder of Fictional Co. In 2025, Invest Corp. sells its Fictional Co. shares, resulting in long-term capital gain, 50 percent of which is passed through to Jack for federal income tax purposes.

Result: The long-term capital gain from the sale of the Fictional Co. stock is allocated to Washington because the stock is intangible personal property and the taxpayer, Jack, was domiciled in Washington at the time the sale occurred.