

# Multiple Agency Fiscal Note Summary

<b>Bill Number:</b> 1496 HB	<b>Title:</b> High valued assets tax
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## Estimated Cash Receipts

Agency Name	2021-23			2023-25			2025-27		
	GF-State	NGF-Outlook	Total	GF-State	NGF-Outlook	Total	GF-State	NGF-Outlook	Total
Department of Revenue	365,000,000	365,000,000	835,000,000	789,000,000	789,000,000	1,803,000,000	623,000,000	623,000,000	1,917,000,000
<b>Total \$</b>	<b>365,000,000</b>	<b>365,000,000</b>	<b>835,000,000</b>	<b>789,000,000</b>	<b>789,000,000</b>	<b>1,803,000,000</b>	<b>623,000,000</b>	<b>623,000,000</b>	<b>1,917,000,000</b>

## Estimated Operating Expenditures

Agency Name	2021-23				2023-25				2025-27			
	FTEs	GF-State	NGF-Outlook	Total	FTEs	GF-State	NGF-Outlook	Total	FTEs	GF-State	NGF-Outlook	Total
Office of State Treasurer	Fiscal note not available											
Department of Revenue	15.6	5,809,100	5,809,100	5,809,100	13.2	5,900,300	5,900,300	5,900,300	9.8	3,170,000	3,170,000	3,170,000
<b>Total \$</b>	<b>15.6</b>	<b>5,809,100</b>	<b>5,809,100</b>	<b>5,809,100</b>	<b>13.2</b>	<b>5,900,300</b>	<b>5,900,300</b>	<b>5,900,300</b>	<b>9.8</b>	<b>3,170,000</b>	<b>3,170,000</b>	<b>3,170,000</b>

## Estimated Capital Budget Expenditures

Agency Name	2021-23			2023-25			2025-27		
	FTEs	Bonds	Total	FTEs	Bonds	Total	FTEs	Bonds	Total
Office of State Treasurer	Fiscal note not available								
Department of Revenue	.0	0	0	.0	0	0	.0	0	0
<b>Total \$</b>	<b>0.0</b>	<b>0</b>	<b>0</b>	<b>0.0</b>	<b>0</b>	<b>0</b>	<b>0.0</b>	<b>0</b>	<b>0</b>

## Estimated Capital Budget Breakout

NONE

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<b>Prepared by:</b> Ramona Nabors, OFM	<b>Phone:</b> (360) 902-0547	<b>Date Published:</b> Preliminary 2/10/2021
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# Department of Revenue Fiscal Note

<b>Bill Number:</b> 1496 HB	<b>Title:</b> High valued assets tax	<b>Agency:</b> 140-Department of Revenue
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## Part I: Estimates

No Fiscal Impact

### Estimated Cash Receipts to:

Account	FY 2022	FY 2023	2021-23	2023-25	2025-27
GF-STATE-State 00 - 00 -		470,000,000	470,000,000	1,014,000,000	863,000,000
GF-STATE-State 01 - Taxes 05 - Bus and Occup Tax		(105,000,000)	(105,000,000)	(225,000,000)	(240,000,000)
NEW-State 00 - 00 -		470,000,000	470,000,000	1,014,000,000	1,294,000,000
<b>Total \$</b>		835,000,000	835,000,000	1,803,000,000	1,917,000,000

### Estimated Expenditures from:

Account	FY 2022	FY 2023	2021-23	2023-25	2025-27
FTE Staff Years	13.5	17.6	15.6	13.2	9.8
GF-STATE-State 001-1	2,284,300	3,524,800	5,809,100	5,900,300	3,170,000
<b>Total \$</b>	2,284,300	3,524,800	5,809,100	5,900,300	3,170,000

### Estimated Capital Budget Impact:

NONE

*The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.*

Check applicable boxes and follow corresponding instructions:

- If fiscal impact is greater than \$50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.
- If fiscal impact is less than \$50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).
- Capital budget impact, complete Part IV.
- Requires new rule making, complete Part V.

Legislative Contact: Tracey OBrien	Phone: 360-786-7152	Date: 02/04/2021
Agency Preparation: Sara del Moral	Phone: 360-534-1525	Date: 02/10/2021
Agency Approval: Kim Davis	Phone: 360-534-1508	Date: 02/10/2021
OFM Review: Ramona Nabors	Phone: (360) 902-0547	Date: 02/10/2021

Request # 1496-1-1

## Part II: Narrative Explanation

### II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

*Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.*

#### CURRENT LAW:

There is no capital gains tax in Washington State.

#### PROPOSAL:

This bill imposes a tax on all individuals for the privilege of selling or exchanging long-term capital assets. The tax takes effect January 1, 2022. The taxable amount is an individual's Washington capital gains. The tax rates are:

- 7.0 percent for capital gains on real property.
- 9.9 percent for capital gains on all other assets.

After exempting certain capital gains based on the type of asset sold or exchanged, a standard exemption is available in the amount of:

- \$200,000 for single filers; and
- \$400,000 for joint filers.

#### WASHINGTON CAPITAL GAINS

The amount of Washington capital gains is computed by adjusting each individual's federal long-term net capital gains as follows:

- Only gains or losses from the sale or exchange of capital assets sourced in Washington are subject to the tax. Losses resulting from the sale or exchange of assets located elsewhere may not be used to reduce the taxable amount.
- No adjustments to the federal amount for Sec. 1031 exchanges are made if the transaction involved Washington assets exchanged for Washington assets. Individuals must file an information return, and may eventually owe tax on deferred Washington capital gains, if the Sec. 1031 exchange involved Washington assets exchanged for non-Washington assets.

Each taxpayer with Washington capital gains equaling or exceeding the filing threshold must file a tax return, even if no tax is due. The threshold is:

- \$150,000 for single filers; and
- \$300,000 for joint filers.

#### EXEMPTIONS BASED ON TYPE OF ASSET SOLD OR EXCHANGED

The capital gains tax does not apply to the following:

- Capital gains exempted from the federal income tax, such as gains (1) from the sale or exchange of certain primary residence or (2) received from retirement accounts.
- The sale or exchange of principal place of residence with a selling price of \$5,000,000 or less.
- The sale or exchange of assets under most retirement savings vehicles.
- Capital gains from the sale or exchange of assets sold or exchanged under condemnation proceedings or imminent threat of condemnation.
- The sale or exchange of cattle, horses, or breeding livestock held for more than 12 months by farmers if more than 50 percent of the taxpayer's gross income is from farming or ranching.
- The sale or exchange of agricultural land by an individual meeting certain requirements.
- The sale or exchange of depreciable property used in a business, if it qualifies for a deduction under Internal Revenue Code section 167 or expensing under Internal Revenue Code section 179.
- The sale or exchange of timber or timberland, or the receipt of Washington capital gains as dividends and distributions from real estate investment trusts derived from gains from the sale or exchange of timber or timberland.

#### DEDUCTIONS

Request # 1496-1-1

**Qualified Family-Owned Small Business Deduction:** A deduction is provided for capital gains derived from the sale of substantially all of the assets, or the transfer of substantially all of a person's interest, in a qualified family owned small business. To qualify, a taxpayer or a family member must have materially participated in the operation of the business for at least 5 of the 8 years preceding the sale or transfer. Sales or transfers to qualified heirs are exempt from the material participation requirement.

To qualify for the deduction, a taxpayer must meet several requirements.

- "Substantially all" means 90 percent:
- Sale of assets: The sale is of at least 90 percent of the fair market value of the assets of the business. Assets include real property, tangible personal property, and intangible property.
- Transfer of interest: The transfer must be of at least 90 percent of a person's interest in a business. E.g., a person owning 50 percent of the business must transfer at least 45 percent of the business ownership (i.e., 90 percent of their share).

**Qualified family owned small business:**

- Can be a sole proprietorship, or
- An interest in an entity carrying on a trade or business if at least:
  - 50 percent of the entity is owned by a taxpayer and members of their family,
  - 70 percent of the entity is owned by two families and at least 30 percent is owned by a taxpayer and their family, or
  - 90 percent of the entity is owned by three families and at least 30 percent is owned by a taxpayer and their family.

**Small business:** A small business must have 50 or fewer employees and gross revenue of \$10 million or less for the 12 months immediately preceding the sale or transfer.

**Material participation:**

- A taxpayer, or their family, owned or had a qualifying interest in the business for at least 8 years immediately prior to the sale of assets or transfer of interest.
- During the 8-year period, there must be periods aggregating at least 5 years during which a taxpayer or a member of their family materially participated in the operation of the trade or business.
- Exception: The material participation requirement does not apply to sales of assets or transfers of interests to qualified heirs.

**Legally prohibited amounts:** A deduction is allowed for amounts the state is prohibited from taxing under federal law or the constitutions of the United States or the state of Washington.

## CREDITS

**B&O credit:** A credit against the business and occupation (B&O) tax is allowed, to avoid taxing the same sale or exchange under both the B&O and capital gains taxes.

**Out-of-state credit:** A credit against the capital gains tax is allowed for the amount of capital gains taxes paid to another taxing jurisdiction on capital gains derived from sources within the other taxing jurisdiction to the extent the capital gains are included in the measure of the Washington capital gains tax.

**REET credit:** A credit is allowed if a taxpayer paid the state real estate excise tax (REET) in association with the sale or exchange of real property that is also taxable for the purpose of the capital gains tax. The credit amount is the lesser of:

- \$10,000, or
- 10 percent of the state REET paid.

## FILING DEADLINES

Washington capital gains tax returns, any required information returns, and payments are due at the same time that the taxpayer's federal income tax return for the taxable year is due. Individuals receiving a federal tax filing extension also qualify for a state capital gains tax filing extension, but the tax is still due on the original filing date.

## REVENUES

Through Fiscal Year 2025, revenues will be deposited as follows:

- 50 percent to the Fair Start for Kids Account created under HB 1213 (2021), and
- 50 percent to the State General Fund.

Beginning with Fiscal Year 2026, revenues will be deposited as follows:

- 60 percent to the Fair Start for Kids Account created under HB 1213 (2021), and
- 40 percent to the State General Fund.

## EFFECTIVE DATE:

The bill takes effect 90 days after final adjournment of the session in which it is enacted.

## II. B - Cash receipts Impact

*Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.*

## ASSUMPTIONS:

- Approximately 7,000 taxpayers pay capital gains taxes for taxes due in 2023.
- The NEW fund in the table above corresponds to the Fair Start for Kids Account, proposed under HB 1213 (2021).
- The tax takes effect on January 1, 2022, and the first payments are due April 15, 2023.
- The long-term net capital gains reported on Washington residents' federal tax returns are equivalent to the Washington capital gains for all taxpayers, including nonresidents.
- Taxpayers may only consider losses allocated to the state under sec. 207 when calculating their adjusted capital gains and Washington capital gains. Losses not allocated to the state under sec. 207 cannot be used to reduce a taxpayer's adjusted capital gains. Limiting available losses to losses allocated to the state would have a minimal but positive impact on revenues. But for the purpose of this estimate, we assume the impact is zero due to a lack of information about how gains and losses are allocated to the state in the data available.
- Decoupling certain federal deferral programs, such as the Federal Opportunity Zone program, from the meaning of "net long-term capital gain" used for federal tax purposes would have a minimal but positive impact on revenues.
- We assume that among capital gains relating to the sale or exchange of a residence, only the sale or exchange of vacation homes, second homes, and rental residences would be taxable. Based on this, we assume 90 percent of federal capital gains related to the sale or exchange of a residence would be exempt from the tax.
- For purposes of the exemption for depreciable business property, 80 percent of capital gains relating to the sale or exchange of residential rental property are exempt, as they relate to the sale or exchange of depreciable improvements, rather than non-depreciable land.
- When we apply the lower tax rate for real property, instead of regular tax rate, the percentage of a Washington taxpayer's gains resulting from such exchanges aligns with percentages reported in IRS / SOI statistical tables for all taxpayers nationwide.
- For the purpose of estimating the amount of pass-through capital gains exempted, we assume:
  - The types of assets sold or exchanged for capital gains align with the types of assets held by all U.S. S-corporations and partnerships for Tax Year 2014.
  - Sales or exchanges from 50 percent of depreciable business assets are exempt.
  - Sales or exchanges from 9 percent of land held by S-corporations are exempt.
  - Sales or exchanges from 6 percent of land held by partnerships are exempt.

- No estimated payments or withholdings are made during the year.
- For all asset types excluded from the tax, the percentage of a Washington taxpayer's gains resulting from sales or exchanges of these assets aligns with percentages reported in IRS / SOI statistical tables for all taxpayers nationwide.
- All Washington firms with \$10 million or less in annual gross revenues qualify as family-owned small businesses and are allowed a deduction.
- The average effective rate for the real estate excise tax (REET), for taxpayers who use the REET credit, was 1.18 percent, which is the effective rate we estimated for vacation homes in top vacation destinations in Washington.
- The filing threshold applies to the adjusted Washington capital gains, calculated as the federal long-term net capital gains minus exemptions under Sec. 203 and allocated to Washington under section 207.

**B&O credit:**

- Each taxpayer maximizes the amount of the credit by applying the standard exemption first to gains realized from personal sources, then applying any remainder to gains from business sources.
- 10 percent of taxable capital gains resulting from business activity in the finance sector is not subject to the B&O tax, because it comes from private equity firms and hedge funds, which qualify for the investment income deduction against the B&O tax.
- The Financial Institutions Surtax for the B&O tax remains in effect.
- Future amounts of capital gains for Washington taxpayers equal the amounts reported in 2018 tax returns, adjusted by using forecasted rates of growth and decay.
- The ratio of the out-of-state credit to gross tax is the same for Tax Years 2017 and 2018.
- HB 1213 (2021) is enacted before the first revenues are received during Fiscal Year 2023; therefore, revenues may be deposited to the new account created under HB 1213.
- Compliance is 90 percent in the first year and 95 percent thereafter.

**DATA SOURCES:**

- Internal Revenue Service (IRS) - Individual income tax returns data, Tax Years 2017 and 2018.
- IRS: SOI Tax Stats - Sales of Capital Assets Report on Individual Tax Returns, Tables 2A and 1C, Tax Years 2008 to 2012.
- IRS Statistics of Income: Returns of Active Corporations, Form 1120S - Table 6.1. Balance Sheet and - - Income Statement Items, by Major Industry, Tax Year 2014.
- IRS Statistics of Income: Table 3. All Partnerships: Balance Sheets by Industrial Group, Tax Year 2016.
- IRS Statistics of Income: Table 5. Partnerships with Income (or Loss) Allocated to Partners, by Selected Industrial Group, Tax Year 2014.
- Department of Revenue: Excise tax data, Calendar Year 2020, Q2, used to estimate effective B&O tax rates for financial sector firms.
- Department of Revenue: Excise tax data, Fiscal Year 2018, used to estimate percentage of gross revenues that come from small businesses.
- Personal Income Forecast (November 2020). This includes the U.S. Congressional Budget Office: Capital gains realizations forecast (all states), August 2020, used to grow capital gains amounts.

**REVENUE ESTIMATES**

**TOTAL REVENUE IMPACT:**

State Government (cash basis, \$000):

FY 2022 -	\$	0
FY 2023 -	\$	835,000
FY 2024 -	\$	891,000
FY 2025 -	\$	912,000
FY 2026 -	\$	942,000
FY 2027 -	\$	975,000

## II. C - Expenditures

*Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.*

### ASSUMPTIONS:

- This legislation affects 11,000 taxpayers, which includes those who are required to file, even if no tax is due.
- Taxpayers will not be required to make estimated payments.

### FIRST YEAR COSTS:

The Department will incur total costs of \$2,284,300 in Fiscal Year 2022. These costs include:

Labor Costs - Time and effort equates to 13.54 FTE.

- Provide technical advice, interpretation and analysis during the implementation process.
- Program, setup, test and verify computer systems to accept taxpayer returns and other required information and process reporting information for collection, audit, and refund purposes.
- Develop training for processing and working with capital gains tax returns.
- Answer phone calls and counter inquiries on tax questions and tax return preparation from businesses, individuals, and accountants.
- Update and maintain hard copy and online educational and informational materials.
- Create a special notice and update website and published information.
- Respond to tax ruling requests and email inquiries.
- Adopt two new administrative rules.

Object Costs - \$548,200.

- Contract computer system programming.
- Purchase additional server equipment.
- Print and mail outreach materials, general correspondence, notices and returns to paper filers.

### SECOND YEAR COSTS:

The Department will incur total costs of \$3,524,800 in Fiscal Year 2023. These costs include:

Labor Costs - Time and effort equates to 17.6 FTE.

- Provide technical advice and interpretation services.
- Ongoing programming and testing of computer systems.
- Ongoing training development and training for the new tax.
- Create returns and design and develop new templates and forms.
- Answer phone calls and counter inquiries on tax questions and tax return preparation from individuals and accountants.
- Update and maintain hard copy and online educational and informational materials.
- Respond to tax ruling requests and email inquiries.
- Establish new reporting accounts for capital gains taxpayers.
- Process paper returns and associated work items.
- Resolve error and out of balance returns, conduct desk audits, prepare refunds and assessments.
- Collect delinquent assessments as a result of return errors.
- Hear additional administrative reviews.

Object Costs - \$1,569,800.

- Contract computer system programming.
- Purchase additional server equipment.
- Print and mail a special notice to affected taxpayers.
- Acquire additional seat licenses for the Telephone Information Center.

- Acquire informational brochures.
- Print and mail outreach materials, general correspondence, notices and returns to paper filers.
- Background checks for employees working with Internal Revenue Service data.
- Legal assistance from the Office of the Attorney General.

**THIRD YEAR COSTS:**

The Department will incur total costs of \$3,540,500 in Fiscal Year 2024. These costs include:

Labor Costs - Time and effort equates to 13.8 FTE.

- Provide technical advice and interpretation services.
- Ongoing programming and testing of computer systems including receiving and processing Internal Revenue Service information for verification of reporting and tax discovery.
- Ongoing training for the new tax.
- Answer phone calls and counter inquiries on tax questions and tax return preparation from businesses, individuals, and accountants.
- Update and maintain hard copy and online educational and informational materials.
- Respond to tax ruling requests and email inquiries.
- Establish new reporting accounts for capital gains taxpayers.
- Process returns, payments and all associated work items, including issuing assessments for return errors and underpayments.
- Assist taxpayers with reporting questions and respond to inquiries via email, web message, and paper correspondence.
- Collect delinquent assessments as a result of return errors.
- Hear additional administrative reviews.

Object Costs - \$2,069,700.

- Contract computer system programming.
- Purchase additional server equipment.
- Print and mail outreach materials, general correspondence, notices and returns to paper filers.
- Acquire informational brochures.
- Background checks for employees working with Internal Revenue Service data.
- Legal assistance from the Office of the Attorney General.

**ONGOING COSTS:**

Ongoing costs for Fiscal Year 2025 equal \$2,359,800 and include similar activities described in the third year costs. Time and effort equates to 12.5 FTE.

**Part III: Expenditure Detail**

**III. A - Expenditures by Object Or Purpose**

	FY 2022	FY 2023	2021-23	2023-25	2025-27
FTE Staff Years	13.5	17.6	15.6	13.2	9.8
A-Salaries and Wages	1,079,700	1,243,700	2,323,400	1,811,800	1,367,600
B-Employee Benefits	388,500	447,600	836,100	652,100	492,600
C-Professional Service Contracts	500,000	1,500,000	2,000,000	3,000,000	1,000,000
E-Goods and Other Services	181,100	270,900	452,000	386,400	273,800
G-Travel	300	600	900	600	600
J-Capital Outlays	134,700	62,000	196,700	49,400	35,400
<b>Total \$</b>	<b>\$2,284,300</b>	<b>\$3,524,800</b>	<b>\$5,809,100</b>	<b>\$5,900,300</b>	<b>\$3,170,000</b>



**III. B - Detail:** List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA

Job Classification	Salary	FY 2022	FY 2023	2021-23	2023-25	2025-27
COMMUNICATIONS CNSLT 4	64,332	0.5	0.5	0.5		
EMS BAND 4	119,061	0.0		0.0		
EMS BAND 5	139,090	0.0		0.0		
EXCISE TAX EX 1	43,392		0.9	0.5	0.5	0.5
EXCISE TAX EX 2	54,108		0.4	0.2	0.9	1.4
EXCISE TAX EX 3	59,688	0.2	0.2	0.2	0.2	0.2
FISCAL ANALYST 3	55,524		0.1	0.1	0.1	0.1
IT APP DEV-JOURNEY	85,644	1.0	1.0	1.0	0.5	0.5
IT B A-JOURNEY	85,644	0.5	0.5	0.5	0.3	0.3
IT PROJ MGT-JOURNEY	89,916	1.0	1.0	1.0	0.5	0.5
IT QA-JOURNEY	85,644	1.5	1.5	1.5	0.8	0.8
MGMT ANALYST4	70,956	3.3	3.7	3.5	2.7	1.7
MGMT ANALYST5	78,408	0.6	0.6	0.6	0.3	0.1
RECORDS MGMT SUPV	67,560	0.1	0.3	0.2		
REVENUE AGENT 4	64,332		0.3	0.2	0.3	0.3
TAX INFO SPEC 1	43,392		2.5	1.3	2.3	1.0
TAX INFO SPEC 4	64,332	0.5	1.0	0.8	1.0	0.5
TAX POLICY SP 2	72,756	0.0		0.0		
TAX POLICY SP 3	82,344	2.6	1.7	2.2	1.5	0.8
TAX POLICY SP 4	88,644	0.5	0.4	0.5	0.4	0.1
WMS BAND 2	89,018	1.1	1.0	1.1	1.0	1.0
WMS BAND 3	101,257	0.0		0.0		
<b>Total FTEs</b>		13.5	17.6	15.6	13.2	9.8

**III. C - Expenditures By Program (optional)**

NONE

**Part IV: Capital Budget Impact**

**IV. A - Capital Budget Expenditures**

NONE

**IV. B - Expenditures by Object Or Purpose**

NONE

**IV. C - Capital Budget Breakout**

Identify acquisition and construction costs not reflected elsewhere on the fiscal note and describe potential financing methods

NONE

None.

**Part V: New Rule Making Required**

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

Should this legislation become law, the Department will adopt two new rules under 458-20 WAC, one using the complex process and one using the standard process. Persons affected by this rule making would include Individuals meeting the

threshold for reporting and/or paying the new capital gains tax.



# Ten-Year Analysis

<b>Bill Number</b> 1496 HB	<b>Title</b> High valued assets tax	<b>Agency</b> 140 Department of Revenue
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This ten-year analysis is limited to agency estimated cash receipts associated with the proposed tax or fee increases. The Office of Financial Management ten-year projection can be found at <http://www.ofm.wa.gov/tax/default.asp>.

## Estimates

**No Cash Receipts**
                 
  **Partially Indeterminate Cash Receipts**
                 
  **Indeterminate Cash Receipts**

## Estimated Cash Receipts

Name of Tax or Fee	Acct Code	Fiscal Year 2022	Fiscal Year 2023	Fiscal Year 2024	Fiscal Year 2025	Fiscal Year 2026	Fiscal Year 2027	Fiscal Year 2028	Fiscal Year 2029	Fiscal Year 2030	Fiscal Year 2031	2022-31 TOTAL
Business & Occupation Tax	001		(105,000,000)	(111,000,000)	(114,000,000)	(118,000,000)	(122,000,000)	(127,000,000)	(132,000,000)	(137,000,000)	(142,000,000)	(1,108,000,000)
Capital Gains Tax	001		470,000,000	501,000,000	513,000,000	424,000,000	439,000,000	456,000,000	475,000,000	493,000,000	513,000,000	4,284,000,000
Capital Gains Tax	NEW		470,000,000	501,000,000	513,000,000	636,000,000	658,000,000	684,000,000	712,000,000	740,000,000	770,000,000	5,684,000,000
<b>Total Capital Gains Tax</b>			<b>940,000,000</b>	<b>1,002,000,000</b>	<b>1,026,000,000</b>	<b>1,060,000,000</b>	<b>1,097,000,000</b>	<b>1,140,000,000</b>	<b>1,187,000,000</b>	<b>1,233,000,000</b>	<b>1,283,000,000</b>	<b>9,968,000,000</b>
<b>Total</b>			<b>835,000,000</b>	<b>891,000,000</b>	<b>912,000,000</b>	<b>942,000,000</b>	<b>975,000,000</b>	<b>1,013,000,000</b>	<b>1,055,000,000</b>	<b>1,096,000,000</b>	<b>1,141,000,000</b>	<b>8,860,000,000</b>
<b>Biennial Totals</b>			<b>835,000,000</b>	<b>1,803,000,000</b>	<b>1,917,000,000</b>	<b>2,068,000,000</b>	<b>2,237,000,000</b>	<b>2,370,000,000</b>	<b>2,527,000,000</b>	<b>2,683,000,000</b>	<b>2,844,000,000</b>	<b>8,860,000,000</b>

## Narrative Explanation (Required for Indeterminate Cash Receipts)

### CURRENT LAW:

There is no capital gains tax in Washington State.

### PROPOSAL:

This bill imposes a tax on all individuals for the privilege of selling or exchanging long-term capital assets. The tax takes effect January 1, 2022. The taxable amount is an individual's Washington capital gains. The tax rates are:

- 7.0 percent for capital gains on real property.
- 9.9 percent for capital gains on all other assets.

After exempting certain capital gains based on the type of asset sold or exchanged, a standard exemption is available in the amount of:

- \$200,000 for single filers; and
- \$400,000 for joint filers.



# Ten-Year Analysis

Bill Number	Title	Agency
1496 HB	High valued assets tax	140 Department of Revenue

This ten-year analysis is limited to agency estimated cash receipts associated with the proposed tax or fee increases. The Office of Financial Management ten-year projection can be found at <http://www.ofm.wa.gov/tax/default.asp>.

## Narrative Explanation (Required for Indeterminate Cash Receipts)

### WASHINGTON CAPITAL GAINS

The amount of Washington capital gains is computed by adjusting each individual's federal long-term net capital gains as follows:

- Only gains or losses from the sale or exchange of capital assets sourced in Washington are subject to the tax. Losses resulting from the sale or exchange of assets located elsewhere may not be used to reduce the taxable amount.
- No adjustments to the federal amount for Sec. 1031 exchanges are made if the transaction involved Washington assets exchanged for Washington assets. Individuals must file an information return, and may eventually owe tax on deferred Washington capital gains, if the Sec. 1031 exchange involved Washington assets exchanged for non-Washington assets.

Each taxpayer with Washington capital gains equaling or exceeding the filing threshold must file a tax return, even if no tax is due. The threshold is:

- \$150,000 for single filers; and
- \$300,000 for joint filers.

### EXEMPTIONS BASED ON TYPE OF ASSET SOLD OR EXCHANGED

The capital gains tax does not apply to the following:

- Capital gains exempted from the federal income tax, such as gains (1) from the sale or exchange of certain primary residence or (2) received from retirement accounts.
- The sale or exchange of principal place of residence with a selling price of \$5,000,000 or less.
- The sale or exchange of assets under most retirement savings vehicles.
- Capital gains from the sale or exchange of assets sold or exchanged under condemnation proceedings or imminent threat of condemnation.
- The sale or exchange of cattle, horses, or breeding livestock held for more than 12 months by farmers if more than 50 percent of the taxpayer's gross income is from farming or ranching.
- The sale or exchange of agricultural land by an individual meeting certain requirements.
- The sale or exchange of depreciable property used in a business, if it qualifies for a deduction under Internal Revenue Code section 167 or expensing under Internal Revenue Code section 179.
- The sale or exchange of timber or timberland, or the receipt of Washington capital gains as dividends and distributions from real estate investment trusts derived from gains from the sale or exchange of timber or timberland.

### DEDUCTIONS

**Qualified Family-Owned Small Business Deduction:** A deduction is provided for capital gains derived from the sale of substantially all of the assets, or the transfer of substantially all of a person's interest, in a qualified family owned small business. To qualify, a taxpayer or a family member must have materially participated in the operation of the business for at least 5 of the 8 years preceding the sale or transfer. Sales or transfers to qualified heirs are exempt from the material participation requirement.



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To qualify for the deduction, a taxpayer must meet several requirements.

- “Substantially all” means 90 percent:
- Sale of assets: The sale is of at least 90 percent of the fair market value of the assets of the business. Assets include real property, tangible personal property, and intangible property.
- Transfer of interest: The transfer must be of at least 90 percent of a person’s interest in a business. E.g., a person owning 50 percent of the business must transfer at least 45 percent of the business ownership (i.e., 90 percent of their share).

Qualified family owned small business:

- Can be a sole proprietorship, or
- An interest in an entity carrying on a trade or business if at least:
  - 50 percent of the entity is owned by a taxpayer and members of their family,
  - 70 percent of the entity is owned by two families and at least 30 percent is owned by a taxpayer and their family, or
  - 90 percent of the entity is owned by three families and at least 30 percent is owned by a taxpayer and their family.

Small business: A small business must have 50 or fewer employees and gross revenue of \$10 million or less for the 12 months immediately preceding the sale or transfer.

Material participation:

- A taxpayer, or their family, owned or had a qualifying interest in the business for at least 8 years immediately prior to the sale of assets or transfer of interest.
- During the 8-year period, there must be periods aggregating at least 5 years during which a taxpayer or a member of their family materially participated in the operation of the trade or business.
- Exception: The material participation requirement does not apply to sales of assets or transfers of interests to qualified heirs.

Legally prohibited amounts: A deduction is allowed for amounts the state is prohibited from taxing under federal law or the constitutions of the United States or the state of Washington.

### CREDITS

B&O credit: A credit against the business and occupation (B&O) tax is allowed, to avoid taxing the same sale or exchange under both the B&O and capital gains taxes.

Out-of-state credit: A credit against the capital gains tax is allowed for the amount of capital gains taxes paid to another taxing jurisdiction on capital gains derived from sources within the other taxing jurisdiction to the extent the capital gains are included in the measure of the Washington capital gains tax.



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## Narrative Explanation (Required for Indeterminate Cash Receipts)

REET credit: A credit is allowed if a taxpayer paid the state real estate excise tax (REET) in association with the sale or exchange of real property that is also taxable for the purpose of the capital gains tax. The credit amount is the lesser of:

- \$10,000, or
- 10 percent of the state REET paid.

### FILING DEADLINES

Washington capital gains tax returns, any required information returns, and payments are due at the same time that the taxpayer's federal income tax return for the taxable year is due. Individuals receiving a federal tax filing extension also qualify for a state capital gains tax filing extension, but the tax is still due on the original filing date.

### REVENUES

Through Fiscal Year 2025, revenues will be deposited as follows:

- 50 percent to the Fair Start for Kids Account created under HB 1213 (2021), and
- 50 percent to the State General Fund.

Beginning with Fiscal Year 2026, revenues will be deposited as follows:

- 60 percent to the Fair Start for Kids Account created under HB 1213 (2021), and
- 40 percent to the State General Fund.

### EFFECTIVE DATE:

The bill takes effect 90 days after final adjournment of the session in which it is enacted.

### ASSUMPTIONS:

- Approximately 7,000 taxpayers pay capital gains taxes for taxes due in 2023.
- The NEW fund in the table above corresponds to the Fair Start for Kids Account, proposed under HB 1213 (2021).
- The tax takes effect on January 1, 2022, and the first payments are due April 15, 2023.
- The long-term net capital gains reported on Washington residents' federal tax returns are equivalent to the Washington capital gains for all taxpayers, including nonresidents.
- Taxpayers may only consider losses allocated to the state under sec. 207 when calculating their adjusted capital gains and Washington capital gains. Losses not allocated to the state under sec. 207 cannot be used to reduce a taxpayer's adjusted capital gains. Limiting available losses to losses allocated to the state would have a minimal but positive impact on revenues. But for the purpose of this estimate, we assume the impact is zero due to a lack of information about how gains and losses are



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## Narrative Explanation (Required for Indeterminate Cash Receipts)

allocated to the state in the data available.

- Decoupling certain federal deferral programs, such as the Federal Opportunity Zone program, from the meaning of “net long-term capital gain” used for federal tax purposes would have a minimal but positive impact on revenues.
- We assume that among capital gains relating to the sale or exchange of a residence, only the sale or exchange of vacation homes, second homes, and rental residences would be taxable. Based on this, we assume 90 percent of federal capital gains related to the sale or exchange of a residence would be exempt from the tax.
- For purposes of the exemption for depreciable business property, 80 percent of capital gains relating to the sale or exchange of residential rental property are exempt, as they relate to the sale or exchange of depreciable improvements, rather than non-depreciable land.
- When we apply the lower tax rate for real property, instead of regular tax rate, the percentage of a Washington taxpayer’s gains resulting from such exchanges aligns with percentages reported in IRS / SOI statistical tables for all taxpayers nationwide.
- For the purpose of estimating the amount of pass-through capital gains exempted, we assume:
  - The types of assets sold or exchanged for capital gains align with the types of assets held by all U.S. S-corporations and partnerships for Tax Year 2014.
  - Sales or exchanges from 50 percent of depreciable business assets are exempt.
  - Sales or exchanges from 9 percent of land held by S-corporations are exempt.
  - Sales or exchanges from 6 percent of land held by partnerships are exempt.
- No estimated payments or withholdings are made during the year.
- For all asset types excluded from the tax, the percentage of a Washington taxpayer’s gains resulting from sales or exchanges of these assets aligns with percentages reported in IRS / SOI statistical tables for all taxpayers nationwide.
- All Washington firms with \$10 million or less in annual gross revenues qualify as family-owned small businesses and are allowed a deduction.
- The average effective rate for the real estate excise tax (REET), for taxpayers who use the REET credit, was 1.18 percent, which is the effective rate we estimated for vacation homes in top vacation destinations in Washington.
- The filing threshold applies to the adjusted Washington capital gains, calculated as the federal long-term net capital gains minus exemptions under Sec. 203 and allocated to Washington under section 207.

B&O credit:

- Each taxpayer maximizes the amount of the credit by applying the standard exemption first to gains realized from personal sources, then applying any remainder to gains from business sources.
- 10 percent of taxable capital gains resulting from business activity in the finance sector is not subject to the B&O tax, because it comes from private equity firms and hedge funds, which qualify for the investment income deduction against the B&O tax.
- The Financial Institutions Surtax for the B&O tax remains in effect.
  
- Future amounts of capital gains for Washington taxpayers equal the amounts reported in 2018 tax returns, adjusted by using forecasted rates of growth and decay.



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- The ratio of the out-of-state credit to gross tax is the same for Tax Years 2017 and 2018.
- HB 1213 (2021) is enacted before the first revenues are received during Fiscal Year 2023; therefore, revenues may be deposited to the new account created under HB 1213.
- Compliance is 90 percent in the first year and 95 percent thereafter.

### DATA SOURCES:

- Internal Revenue Service (IRS) - Individual income tax returns data, Tax Years 2017 and 2018.
- IRS: SOI Tax Stats - Sales of Capital Assets Report on Individual Tax Returns, Tables 2A and 1C, Tax Years 2008 to 2012.
- IRS Statistics of Income: Returns of Active Corporations, Form 1120S - Table 6.1. Balance Sheet and - - Income Statement Items, by Major Industry, Tax Year 2014.
- IRS Statistics of Income: Table 3. All Partnerships: Balance Sheets by Industrial Group, Tax Year 2016.
- IRS Statistics of Income: Table 5. Partnerships with Income (or Loss) Allocated to Partners, by Selected Industrial Group, Tax Year 2014.
- Department of Revenue: Excise tax data, Calendar Year 2020, Q2, used to estimate effective B&O tax rates for financial sector firms.
- Department of Revenue: Excise tax data, Fiscal Year 2018, used to estimate percentage of gross revenues that come from small businesses.
- Personal Income Forecast (November 2020). This includes the U.S. Congressional Budget Office: Capital gains realizations forecast (all states), August 2020, used to grow capital gains amounts.

### REVENUE ESTIMATES

#### TOTAL REVENUE IMPACT:

State Government (cash basis, \$000):

FY 2022 -	\$	0
FY 2023 -	\$	835,000
FY 2024 -	\$	891,000
FY 2025 -	\$	912,000
FY 2026 -	\$	942,000
FY 2027 -	\$	975,000

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