



Washington State Excise Tax Measured by Capital Gains

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Basic Overview

Mechanics of the Tax

- Effective as of January 1, 2022, Washington's new excise tax on the sale or exchange of long-term capital assets ("LTCAET") applies a 7% tax on a Washington resident's adjusted long-term capital gains.
- Tax applies to individuals. Individuals are also treated as "beneficial owners" of long-term capital assets held by a pass-through or other disregarded entities to extent of the Individual's ownership in the entity.
- Only applies to gains allocated to Washington state.
- Assessed on federal net long-term capital gains with certain adjustments, primarily to remove capital gains and losses allocated to places outside of Washington

Basic Overview

Mechanics of the Tax

- The Department of Revenue (“DOR”) has released a proposed rule that answers some of the questions raised by the language in the statute.
- The proposed rule is not official yet. A public hearing was held July 12 as part of the mandatory notice and comment period.
- Though not final and not free from ultimate challenge, it is important insight into how the DOR plans on interpreting the statutes and administering the tax.

Allocating Capital Gains

“Resident” and “Domicile”

- In allocating long-term capital gains to Washington state, the first query is whether the gains are a result of the sale of **tangible** personal property (“TPP”) or **intangible** personal property (“IPP”).
 - TPP: Location of property at time of sale or Washington resident.
 - IPP: Domicile.

Allocating Capital Gains: TPP

Mechanics of the Tax

- Gains from the sale of TPP are allocated to Washington in two scenarios:
- First Scenario: The TPP was located in WA at the time of sale.
- Second Scenario:
 - Property was located in WA at any time during the taxable year of sale or the year preceding the year of sale; AND
 - Taxpayer was a WA **resident** at the time of sale; AND
 - Taxpayer was not subject to income or excise tax on the long-term capital gains or losses by another taxing jurisdiction (excluding the federal government).
- Think Artwork, Collectibles, and Horses.

Washington Residents

Mechanics of the Tax

- The term “Resident” means either:
 - Any individual who was domiciled in WA during the tax year, unless the individual during the taxable year:
 - Had no permanent place of abode in WA;
 - Maintained a permanent place of abode outside of WA; and
 - Spent less than 30 days in WA.
 - Any individual who was *not* domiciled in Washington during the taxable year, but maintained a place of abode in WA and was physically present in WA for more than 183 days during the tax year.

Allocating Capital Gains: IPP

Mechanics of the Tax

- Capital Gains from the sale of IPP are allocated to Washington if the individual taxpayer was ***domiciled*** in Washington at the time the sale or exchange occurred.
- The statute does not define “domicile,” but the DOR has released proposed guidance which highlights their interpretation of “domicile,” which conforms to the definition generally applicable in other states.

Washington Domicile

Mechanics of the Tax

- Proposed Guidance from the DOR provides that “domicile” means: A permanent place of abode, coupled with the intent to make the abode one’s home. You intend to return even if you visit or temporarily reside elsewhere. You can only have one domicile at a time.

Washington Domicile

Mechanics of the Tax

- Determining a taxpayer's "domicile" depends on facts and circumstances.
- The DOR will consider:
 - Length of time spent somewhere;
 - Expressed intent to remain or return;
 - Place of business, profession, or employment;
 - Location of bank accounts;
 - Residence and address for federal income and state tax purposes
 - Vehicle registrations/license;
 - Voter registration;
 - Mailing address;
 - Location of personal and real property;
 - Where children attend school;
 - Location of professional or business licenses;
 - Payment of in-state tuition;
 - Location where financial transactions originate;
 - Residence in state for purposes of running for office, obtaining property tax benefit.

Washington Domicile

Mechanics of the Tax

- More information on determining domicile, as well as a checklist of relevant factors:
 - [Overview](#)
 - [Checklist](#)

Washington Domicile

Mechanics of the Tax

- The DOR's proposed rule presumes taxpayer's domicile will match that of a spouse/domestic partner and dependent children.
 - Therefore, taxpayer is presumed to be domiciled in Washington if their spouse and/or children are domiciled in Washington. The opposite is also true as written, but probably not as applied.
 - Unclear whether this presumption can be rebutted, but the DOR does not describe it as an "irrebuttable presumption."

Washington Domicile

Mechanics of the Tax

- The DOR presumes that if a taxpayer is domiciled in Washington at any time during a particular year the taxpayer was a Washington domiciliary at the time any personal property was sold or exchanged during the same year.
 - This means if a taxpayer is domiciled January 1st, changes domicile January 2nd, and sells company December 15th during the same year, DOR presumes the gains are allocated to Washington.
 - Unclear if this presumption is rebuttable, but the DOR does not describe it as an “irrebuttable presumption.”

Washington Domicile

Mechanics of the Tax

- To allocate long-term gain from IPP outside of Washington, the taxpayer needs clear and convincing evidence that they abandoned their Washington domicile.
- This means not only abandonment of prior domicile, but establishment of a new domicile (sailing around the world for a year does not count).
- The burden is on the taxpayer to prove they are not domiciled in Washington.

Deductions

Mechanics of the Tax

Taxpayers may deduct:

- The annual standard deduction of \$250,000, which is the same amount for individuals, married couples, and domestic partners.
- Charitable Contributions for donations to an organization that is eligible to receive a charitable contribution as defined in IRC § 170(c), and is principally directed or managed within the state of Washington.
 - This means the charity's "high-level officers primarily direct, control, and coordinate the organization's activities in Washington."
 - Also only applies to donations over \$250,000 and deduction is capped at \$100,000.
 - Vanguard/Fidelity/Schwab DAFs at a disadvantage over Seattle Foundation under the DOR's proposed rule.

Exemptions

Exemptions

Real Estate

- Gains from the sale of real estate are exempt from the LCAET.
- Long term gains and losses from the sale of interests in a privately held entity are exempt to the extent the gain is **directly attributable** to the real estate owned directly by such entity.
- The DOR reads this statute literally and under a proposed rule, real estate not owned directly by the entity in which an individual is selling or exchanging an interest will not be given the benefit of the exemption.
 - Beware: Single-member disregarded LLCs are respected. The nesting of LLCs can undermine the real estate exemption. Consider pre-sale restructuring.

Exemptions

Miscellaneous

- Assets held in retirement accounts;
- Assets under imminent threat of condemnation proceedings;
- Cattle, horses, or breeding livestock;
- Depreciable property under IRC § 167 or property that qualifies for expensing under IRC § 179.
- The DOR's proposed rule explicitly states intangibles amortizable under IRC § 197 do not qualify for the depreciable property exemption.
- Timber and timberland, including dividends or distributions from REITs derived from gains from the sale or exchange of timber and timberland;
- Commercial fishing privileges; and
- Goodwill received from the sale of an auto dealership.

Other Exemptions

Planning Considerations

- Limited Qualified Family-Owned Business.
- Qualified Small Business Stock.
- IRC § 1245.
- Installment Sales.
- Non-grantor Trusts.

Planning Considerations

Administrative Procedures

Filing

- The return is due at the same time as the individual's federal income tax return, meaning those that extend federally also extend the capital gains tax return.
 - That means those who receive a filing extension for their federal income tax return receive the same extension for the capital gains tax return.
 - However, it does not extend the due date for paying the capital gains tax.
- Those that only have exempt capital gains or less than \$250,000 in capital gains allocated to the state do not need to file a return.
- Unless an exception is obtained, the tax must be paid electronically via SAW through "My DOR" or via ACH bank transfer. See [DOR Electronic Payment Guide](#).

Possible Reduction in Gain for the LTCAET

- Taxpayers subject to the tax likely reach the \$10,000 cap on state and local taxes with other taxes.
- In upholding the LTCAET, the Washington Supreme Court specifically rejected characterizing the tax as an “income tax,” and instead described it as a “excise tax,” like the real estate excise tax (“REET”)
 - The REET is capitalized into basis, reducing gain.
 - It may be possible to similarly capitalize the LTCAET, reducing gain.
 - We drafted an [article](#) discussing this.

Penalty Provisions

- Failure to file a return, along with a copy of the taxpayer's federal income tax return, results in a penalty ranging from 5% - 25%, depending on how long the return remains unfiled.
 - NOTE: The Department MUST cancel this penalty if failure to file the return is due to circumstances beyond the taxpayer's control OR the taxpayer has not been delinquent in filing any return due during the preceding five calendar years.
- Any attempt to knowingly evade payment of the tax results in a class C felony as provided in chapter 9A.20 RCW.
- Any taxpayer who knowingly fails to pay the tax, make returns, keep records, or supply information, is guilty of a gross misdemeanor as provided in chapter 9A.20 RCW.

Limited Guidance

References

- [Chapter 82.87 RCW](#)
- [WAC 458-20-300](#)
- [Proposed Rule – Public Hearing July 12, 2023](#)
- [Web Page from Washington Department of Revenue](#)
- [Capital Gains Tax Return Instructions](#)
- [Overview from Department of Revenue](#)

Possible Challenges to the Tax

- United States Supreme Court appeal.
- An “as applied” challenge in state court.
- Ballot initiative.

Possible Expansion of the Tax

- Seattle Capital Gains Tax? Other cities?
- State raising the rate of the tax and/or lowering the annual standard deduction.
 - [SB 5335](#) was introduced during the legislative session and there are rumblings it will be brought back next year. It expands the capital gains tax, lowering the threshold to \$15,000 and increasing the rate to 8.5%. There also isn't a blanket exemption for real estate; only certain "residential dwellings" would be exempt.
- State income tax.

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