TAXING CAPITAL GAINS

To Build A Better Future For Our Children:

FREQUENTLY ASKED QUESTIONS:

1. **Q: WHAT ARE CAPITAL GAINS?**

A: Capital gains are profits from the sale of corporate stocks, bonds, investment property (not primary residences), and other high-end financial assets.[i]

2. **Q: WOULD THE TAX APPLY TO ALL CAPITAL GAINS?**

A: No. The tax would only apply to capital gains in excess of $50,000 per year for a married couple ($25,000 for single filers).[ii]

3. **Q: WHO WOULD PAY THE TAX?**

A: Because corporate stocks and other financial assets are heavily concentrated among those individuals at the very top of the income scale, the tax would be paid almost exclusively by the very richest Washingtonians.[iii] Exempting the first $50,000 in gains from taxation ensures that middle-class households with small portfolios or savings in mutual funds would pay no additional taxes.

4. **Q: HOW MANY PEOPLE WOULD BE SUBJECT TO THE TAX?**

A: Very few. The vast majority of the tax would be paid by the richest 1 percent of households in Washington state, those with incomes of at least $490,000 per year. Among those households, state taxes would increase by 1.5 percent of annual household income, on average.[iv]

5. **Q: WOULD I OWE ANY CAPITAL GAINS TAXES ON STOCKS THAT I DONATE TO CHARITY?**

A: No. Gifts of stock or other assets to a charity or nonprofit are not subject to federal capital gains taxes and wouldn't be subject to the Washington state capital gains tax either. In fact, gifts of stock are deductible from federal income taxes.

6. **Q:** ***WHAT WOULD THE CAPITAL GAINS TAX RATE BE?***

A: 7 percent. That's lower than the combined state and local sales tax rate in many places. Under current law, working Washingtonians pay up to 9.5 percent in state sales taxes when they buy a pair of shoes, a bar of soap, and other household goods.[v] Yet, millionaires pay nothing when they reap huge windfalls from exclusive Wall Street investment partnerships. A state capital gains tax would help to correct that fundamental imbalance.

7. **Q:** ***HOW MUCH REVENUE WOULD THE TAX GENERATE AND HOW WOULD THOSE FUNDS BE SPENT?***

A: The tax would generate about $800 million per year in new resources, according to the Washington State Department of Revenue.[vi] It is proposed that the revenue would be dedicated to improving basic education in Washington state. That's important because the State Supreme Court recently ruled that policymakers have been underfunding schools for decades. Without generating additional tax revenue, policymakers would be forced to enact deep and damaging cuts to health care, public safety, child care, higher education, and other investments that help create jobs and promote a strong state economy.

8. **Q:** ***I HAVE A LOT OF STOCKS AND OTHER INVESTMENTS IN MY RETIREMENT PLAN. WOULD THE CAPITAL GAINS TAX APPLY TO MY RETIREMENT SAVINGS?***

A: No. Per federal law, the tax would not apply to assets that are invested in a pension plan, a 401K plan, an IRA or ROTH IRA, or other retirement plan that is recognized by the IRS for federal tax purposes. Nor would the tax apply when funds from those plans are drawn down during your retirement.[vii]

9. **Q:** ***DO OTHER STATES HAVE CAPITAL GAINS TAXES?***

A: Yes. Forty-one states tax capital gains. Fourteen states — including our neighboring states of Idaho (7.4%), Oregon (9.9%), and California (13.3%) — tax capital gains at or above the 7 percent rate proposed for Washington state.[viii]

10. **Q:** ***WOULD I PAY THE CAPITAL GAINS TAX WHEN I SELL MY HOUSE?***

A: Not likely. Washington state would hold to federal law, which exempts the first $500,000 ($250,000 for single filers) in profits on the sale of primary residences from the tax. Only 2.8 percent of homes sold in the United States in 2007, the peak of the housing boom, were subject to any federal capital gains taxes as a result of this exemption.[x] Gains from sales of second homes (vacation homes) and investment properties would be taxed.

11. **Q:** ***WOULD INVESTMENTS IN COLLEGE SAVINGS ACCOUNTS BE SUBJECT TO A STATE CAPITAL GAINS TAX?***

A: No. Similar to retirement accounts, funds invested in college savings accounts, such as 529 plans or the state Guaranteed Education Tuition (GET) plan, would not be subject to the state capital gains tax.[xi] Furthermore, the additional resources generated by the tax could help slow the rising costs of college tuition that are making higher education unaffordable for too many of our kids.

12. **Q:** ***WOULD I OWE CAPITAL GAINS TAXES UPON INHERITING A LARGE AMOUNT OF STOCK OR OTHER ASSETS?***

A: No. All capital gains taxes are forgiven when an asset holder dies. If you inherit capital assets, you wouldn't owe anything until you sell them. Even then, you wouldn't owe taxes on gains that accrued before you inherited them. You would only pay taxes on gains (in excess of $50,000) that accrued after you inherited the assets.[xii]

13. **Q:** ***WOULD A STATE CAPITAL GAINS TAX APPLY TO DIVIDEND PAYMENTS?***

A: No. Dividends, which are payments from corporations to shareholders, would not be taxed under the proposal. The tax would only apply to profits from the sale of corporate stocks and other financial assets that exceed $50,000 per year for a married couple ($25,000 for singles).

14. **Q:** ***ISN'T THIS AN INCOME TAX?***

A: No. A capital gains tax is a form of "excise tax," or transactional tax under state law. Capital gains are much different than ordinary paycheck income. While wage and salary earners don't get to choose when they pay taxes on their paycheck incomes, millionaires do get to decide when they buy and sell stock and other financial assets.[xiii]

15. **Q:** ***WOULD A CAPITAL GAINS TAX HARM WASHINGTON'S ECONOMY?***

A: No. The tax would help grow the state economy in the long run by providing new resources for schools, worker retraining, child care, health care, and other investments proven to create jobs and foster robust growth. There is no evidence linking higher taxes on capital gains to lower economic growth.[xiv, xv] Nor is there any credible evidence to support the argument that the wealthy families who would pay the tax would leave Washington state as a result.[xvi]

16. **Q: *WOULD A CAPITAL GAINS TAX HARM SMALL BUSINESSES?***

A: No. The tax only applies to households, not businesses. Some extremely wealthy households own stock in a private partnerships, exclusive investment clubs, or private corporations. Sometimes these entities are able to avoid higher federal corporate taxes by passing windfall stock market profits through to the individual shareholders. Wealthy households would pay taxes on such windfalls to the extent that they exceed $50,000 per year for a married couple ($25,000 for singles).[xvii]

17. **Q: *WOULDN'T A CAPITAL GAINS TAX BE A FORM OF "DOUBLE TAXATION?"***

A: No. The tax would only apply to the gain in a stock's value since it was originally purchased. The tax wouldn't apply to the original purchase price of the stock, which, under the proposal would automatically be deducted along with any taxes paid at the time of its purchase. The gain, or profit from the sale of a stock would not have been taxed previously.

18. **Q: *WOULD THE TAX BE DEDUCTIBLE FOR FEDERAL INCOME TAX PURPOSES?***

A: Yes. The few who would pay the tax would be able to deduct those payments when calculating their federal income taxes. That means up to 40 percent of Washington state capital gains tax payments could be recouped in the form of lower federal tax payments.

19. **Q: *WHAT IF WE DON'T ENACT A CAPITAL GAINS TAX?***

A: Washington state's outdated, 1930s-era tax system would continue to erode, making it ever more difficult for policymakers to maintain existing levels of K-12 and higher education, health care, child care, public safety, and other investments that create jobs and promote a strong state economy.[xviii] Furthermore, it is unlikely policymakers would be able to generate the billions of dollars in new resources needed to implement court-ordered reforms to basic education from Washington state's existing revenue system, which already takes a much larger bite out of lower- and middle-income families' budgets than those with higher incomes.[xix] Instead, funding these reforms would likely come from eliminating investments in health care, child care, higher education, and public safety. Such a cuts-only approach would do great damage to the state economy while imposing enormous costs on struggling families from Aberdeen to Spokane.

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ENDNOTES

[i] See IRS publication 544 (p. 22) for a list of capital assets that could result in taxable capital gain when sold, http://www.irs.gov/pub/irs-pdf/p544.pdf. Sales of timber, farm land, agricultural machinery, and depreciable business property would be exempt in Washington state under Governor Inslee's proposal.

[ii] See a summary of Governor Inslee's proposal prepared by the Office of Financial Management, http://ofm.wa.gov/budget15/highlights/TaxChanges/2014_18_12_7_percent_capital_gains_tax_on_individuals.pdf.

[iii] The Congressional Budget Office, Trends in the Distribution of Household Income Between 1979 and 2007, 2011, p. 26-28, http://www.cbo.gov/sites/default/files/10-25-HouseholdIncome_0.pdf. In this report, the nonpartisan Congressional Budget Office (CBO) found capital gains to be more heavily concentrated among high-income households than any other economic resource. The CBO also found that capital gains were the single largest factor behind rising income inequality in the early 2000s. A summary of CBO's findings is available at http://budgetandpolicy.org/schmudget/capital-gains-becoming-even-more-concentrated-among-richest-few/.

[iv] Summary of Governor Inslee's proposal from the Office of Financial Management, http://ofm.wa.gov/budget15/highlights/TaxChanges/2014_18_12_7_percent_capital_gains_tax_on_individuals.pdf, and analysis from the Institute on Taxation and Economic Policy.

[v] Washington State Department of Revenue, Tax Reference Manual, 2010, p. 1, http://dor.wa.gov/docs/reports/2010/Tax_Reference_2010/07sales.pdf.

[vi] See endnote ii.

[vii] See IRS publication 550, http://www.irs.gov/publications/p550/ar01.html. Capital gains taxes are not applied to gains that accrue to investments held in federally recognized retirement plans – like pension plans, 401(k)s, 403(b)s, IRAs and Roth IRAs. Distributions from those plans are taxed as ordinary income for federal tax purposes. However, Washington state does not have an income tax, meaning distributions would not be subject to any state capital gains taxes.

[viii] Kyle Pomerleau, The High Burden of State and Federal Capital Gains Taxes, 2013, the Tax Foundation, http://taxfoundation.org/article/high-burden-state-and-federal-capital-gains-taxes.

[ix] See endnote ii. It is important to note that the gain from the sale of a primary residence is different than the gross sales price. The gain is the positive difference between the original purchase price and the current selling price, with a deduction for costs of improvements.

[x] National Association of Realtors, http://www.census.gov/compendia/statab/2012/tables/12s0977.pdf. Because of the high federal capital gains tax exemption and other tax breaks for homeownership, the CBO recently found that the effective marginal tax rate on owner-occupied housing to be near zero, http://www.cbo.gov/sites/default/files/cbofiles/attachments/49817-Taxing_Capital_Income_0.pdf, p. 9-10.

[xi] See 529 Plans: Questions and Answers, IRS, http://www.irs.gov/uac/529-Plans:-Questions-and-Answers.

[xii] See Publication 559, from the IRS, http://www.irs.gov/publications/p544/ch03.html#en_US_2013_publink100072611. All capital gains taxes are forgiven when an individual dies. As a result, people who inherit assets only pay taxes on the gain that has accrued since they received the assets – not the gain over the entire life of the asset.

[xiii] Hugh Spitzer, Memorandum: Character of Proposed State Capital Gains Tax, 2011. In a legal memo provided to the Washington State Budget & Policy Center, Hugh Spitzer, an attorney and Professor of Constitutional Law at the University of Washington, argues that a state capital gains tax would be upheld be the State Supreme Court as a legal, "…one-time transaction tax, measured by the profit received upon sale or transfer, rather than a tax on 'income' from capital gains."

[xiv] Thomas Hungerford, The Economic Effects of Capital Gains Taxation, The Congressional Research Service, 2010, http://fas.org/sgp/crs/misc/R40411.pdf. Hungerford reviews the literature on capital gains taxation and economic growth and concludes, "Furthermore, capital gains tax rate reductions, [economists] observe, are unlikely to have much effect on the long-term level of output or the path to the longrun level of output (i.e., economic growth). A tax reduction on capital gains would mostly benefit very high income taxpayers who are likely to save most of any tax reduction. A temporary capital gains tax reduction possibly could have a negative impact on short-term economic growth."
[xv] Chye-Ching Huang, Chuck Marr, Chart Book: 10 Things You Need to Know About the Capital Gains Tax, Center on Budget and Policy Priorities, 2012, http://www.cbpp.org/cms/index.cfm?fa=view&id=3798. Huang and Marr cite a number of studies that find no relationship between capital gains tax rates and economic growth as measured by a variety of indicators.
[xvi] Michael Mazerov, State Taxes Have a Negligible Impact on Americans' Interstate Moves, Center on Budget and Policy Priorities, 2014, http://www.cbpp.org/cms/?fa=view&id=4141. Mazerov reviews extensive economic literature on the relationship between state taxes and interstate moves and concludes, "Taken as a whole, the research strongly refutes the claim that state and local taxes have a significant impact on migration."
[xvii] Jane Gravelle, Capital Gains Taxes, Innovation and Growth, Congressional Research Services Report for Congress, http://wikileaks.org/wiki/CRS:_CAPITAL_GAINS_TAXES,_INNOVATION_AND_GROWTH,_July_14,_1999. Gravelle reviews literature and economic theory on the relationship between venture capital – investments in small, start-up businesses – and capital gains taxes. She finds that the vast majority (88 percent) of venture capital is supplied by entities that are not subject to individual capital gains taxes, like insurance companies, pension plans, endowments, and foundations. She also notes that the small number of individual venture capital investors have been shown to be insensitive to capital gains tax rates. In fact, venture capital from individuals increased following the federal tax reforms in 1986 and 1987, which involved significant increases in the federal capital gains tax rates. She concludes "The pattern of venture capital provided over time does not support a strong role for a capital gains tax."
[xviii] Andy Nicholas, Washington State's 1930s Tax System Doesn't Work In A 21st Century Economy, 2013, Washington State Budget & Policy Center, http://budgetandpolicy.org/reports/washington-state2019s-1930s-tax-system-doesn2019t-work-in-a-21st-century-economy/pdf_version.
[xix] Institute on Taxation and Economic Policy, Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, fourth edition, 2013, http://www.itep.org/pdf/whopaysreport.pdf.