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Washington Lawmakers Continue Debate Over Capital Gains Tax to Fund Education

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Summary by **taxanalysts**

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In December Gov. Jay Inslee (D) proposed creating a 7 percent capital gains tax on annual earnings over \$25,000 for individuals and \$50,000 for couples, with exceptions for most retirement accounts, homes, farms, and forestry. In late March, House Finance Committee Chair Reuven Carlyle (D) proposed HB 2224, a revenue bill including a 5 percent capital gains tax with similar exceptions. Also, two bills introduced in April by Democrats in the Republican-controlled Senate -- SB 6102 and SB 6104 -- would impose a 7 percent capital gains tax.

The legislation is intended to fund education in the state following the Washington Supreme Court's ruling in *McCleary v. State of Washington*, in which the court found that the state government wasn't adequately funding education. Democrats, who control the House, used Carlyle's bill to craft their official budget proposal.

According to House Democrats, as with Inslee's proposal, the capital gains tax proposed in HB 2224 would apply only to earnings above \$25,000 for individuals and \$50,000 for couples and, along with other tax measures such as an increased business and occupation tax, would bring in \$1.5 billion in new revenue over the 2015-2017 fiscal biennium. House Democrats estimate Carlyle's proposal would affect about 32,000 households.

However, HB 2224 still hasn't moved from the Finance Committee, and Republicans in the Senate oppose the new tax. Capitol observers say the budget fight likely won't end by the April 26 close of the legislative session.

"I'm not sure the Carlyle bill even has votes to get out of committee," said Kriss Sjolom, research director and senior economist for the Washington Research Council, which opposes a capital gains tax. "We're now in the endgame of negotiating. The Senate

[Republican majority] is taking the position that 'We're not going to negotiate over a bill you haven't passed.'"

A spokeswoman with Carlyle's office said negotiations over HB 2224 are ongoing.

The Republican-controlled Senate's budget plan (SB 5077) doesn't create or raise taxes but shifts general fund revenue and marijuana taxes to provide an additional \$1.3 billion in education funding. Unlike the House budget (PSHB 1106), which is backed by Inslee, the Republicans' budget would provide a smaller raise for educators and would limit efforts to reduce class sizes.

The clock is running out for the regular session. House Appropriations Committee Chair Ross Hunter (D) said in an online post, "We need to come to agreement by Wednesday the 22nd" to be able to close out by the end of the regular session.

Apart from the state's court-ordered mandate to increase education funding, the fight over the capital gains tax proposal is significant in that it's the closest the state has come in years to taxing capital gains.

Democrats and supporters of a capital gains tax say the proposal is as much about fairness as it is about funding education in the state. In a news release announcing his proposal last year, Inslee said the state's tax burden falls too heavily on lower- and middle-income taxpayers.

A new capital gains tax "avoids an additional burden on the vast majority of Washington taxpayers" while generating new revenue to fill the education funding gap, Inslee said.

The Washington State Budget and Policy Center echoed that sentiment in a March report praising HB 2224. According to the group, a capital gains tax would improve the stability of the state's tax base by "adding a rapidly growing component to Washington's revenue mix."

Critics argue that a new capital gains tax could hurt the state. Sjoblom said a 5 percent tax would put Washington's rate roughly in the middle in terms of other states' capital gains tax rates, but he warned that the proposal could hurt development in the state.

"It applies to sales of real property and applies to out-of-state individual sales of real property," he said, adding that the tax could increase the cost of buying property, which would affect development of shopping centers and other commercial development.

Sjoblom also said the state's tech startup industry could be negatively affected. "I worry that if you have someone who's involved in the tech sector" who owns shares in a startup that could become valuable, "they'll think, 'If I move to Wyoming, I won't have to pay this capital gains tax,'" he said. If startup owners leave the state to avoid taxes, they won't reinvest their earnings in Washington, Sjoblom said.

While budget negotiations continue, it's unclear what will become of the capital gains tax proposal. A spokesman with Inslee's office said he couldn't comment on negotiations. The

Senate Republican and House Democrat caucuses didn't return requests for comment by press time.

Sjoblom said the only thing he expects is the unexpected. "The final tax bill that comes out will be a big surprise for everyone -- it always is."

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