

How does the capital gains tax support our communities?

And other frequently asked questions

In 2021, lawmakers listened to the calls of community advocates to pass a capital gains excise tax on extraordinary profits. The enactment of this commonsense tax doesn't just ensure that ultra-wealthy people pay what they owe in taxes; it also makes our state tax code more equitable and provides critical funding to schools and child care. In short, this tax will stimulate Washington's economy, provide much-needed relief to people with young children, and start to fix our notoriously upside-down tax code – in which the people with the least pay the most in taxes as a share of income. But currently, a small group of wealthy people are fighting against this policy in the courts. **So to set the record straight, we have some answers to frequently asked questions about the capital gains tax:**

1. What are capital gains?

Capital gains are profits people receive from the sale of corporate stocks, bonds, and other high-end financial assets.¹

2. Who will pay the Washington state capital gains tax?

The tax will almost exclusively be paid by 0.2% of the wealthiest Washingtonians in the state – those with average incomes of more than \$2 million per year.² This means that fewer than 8,200 households would pay the tax. Among those households, state and local taxes would increase by less than 3% of annual household income, on average.³ The majority of households paying the capital gains tax also reside in the wealthiest communities in King County.⁴

3. What is the capital gains tax rate?

The tax rate is 7% of the profits received from the sale of capital gains. That's less than the combined state and local sales tax rate. Washingtonians pay up to 10.5% in sales taxes when they buy clothes, toiletries, and other common household goods.⁵ Yet, millionaires have been paying nothing when reaping huge profits from the sales of high-end financial assets. The state capital gains tax helps to correct that fundamental imbalance in our state's tax code.

4. How much revenue does the tax generate and how would it be spent?

Once fully implemented, the tax will generate well over \$500 million per year in revenue.⁶ Under the law, the first \$500 million in annual state capital gains tax revenue is dedicated to K-12 school operations and funding to support affordable child care and early learning supports for younger children. All annual revenues above \$500 million are dedicated to building and repairing schools across Washington.⁷

5. What makes this an excise tax?

An excise tax is a tax that applies to a transaction, like the sale of real estate or gas at the pump. The legislation clearly outlines and structures this tax as a capital gains excise tax. Capital gains are much different than ordinary paycheck income. The tax is applied in the event of a sale of stocks or other financial assets that result in profit, where the amount of the profit from the sale is taxed. A person can hold stocks and other financial assets that do increase in value over the year and not be taxed because they do not sell their shares or assets. (The people challenging the capital gains tax in Washington's courts are, however, arguing it should be considered an unconstitutional property tax.)

6. Does this excise tax apply to all profits on the sale of financial assets?

No. The excise tax on capital gains only applies to the sale or exchange of capital gains in excess of \$250,000 (applied to single filers, married filing jointly, and married filing separately) per year.⁸ As described in more detail in the following questions, other common assets are also exempt from taxation.

7. Will people owe capital gains taxes on stocks that they donate to charity?

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, Washington taxpayers can deduct up to \$100,000 in contributions to charity from any qualified source, not just in stock.⁹

8. If someone has stocks and other investments in a retirement plan, will the capital gains tax apply to their retirement savings?

No. The tax would not apply to assets that are invested in a pension plan, a 401(k) plan, an Individual Retirement Arrangement (IRA), 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 retirement.¹⁰

9. If a person sells their home, would they pay the capital gains tax?

No. The capital gains tax does not apply to profits on the sale of real estate, which includes residential property like houses, condominiums, houseboats, duplexes and triplexes, and non-corporate-owned investment properties.¹¹

10. Would a capital gains tax be applied to small businesses and small farms?

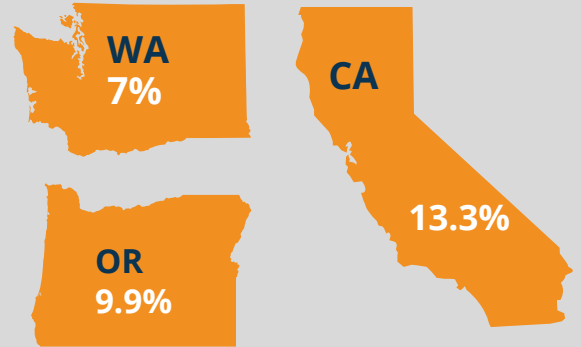
No. The tax only applies to individuals or households, not businesses. Profits on the sale of family-owned small businesses, commercial fishing privileges, timber and timberlands, livestock, and goodwill from the sale of an auto dealership are also exempt from this state tax.¹²

11. Would you owe the tax if you inherit a large amount of stock or assets?

No. All capital gains taxes are forgiven when an asset holder dies. If you inherit capital assets, you would only pay capital gains tax if and when you sell those assets.¹³

12. Do other states have capital gains taxes?

Yes. Forty-one other states tax capital gains. Twelve states tax capital gains at or above the 7% rate of Washington's capital gains tax rate, including Oregon (9.9%) and California (13.3%).¹⁴



13. Would a capital gains excise tax be good for Washington's economy?

Yes. The tax would help grow the state economy through funding resources for schools and school construction, job retraining, child care, and other investments proven to create jobs and foster robust growth.

14. Who was behind the passage of the capital gains tax bill?

Advocates called for the passage of a tax on capital gains in our state for many years because they wanted better community investments and fixes to our unjust tax code – in which low- and middle-income families pay up to seven times more in state and local taxes than the wealthiest 1% as a share of income. The capital gains tax passed during the 2021 legislative session because legislators, organizers, advocates, and others came together to make the tax code more equitable and invest in our communities to address the economic crisis. The passage of the tax in 2021 was a historic legislative victory that moved our tax code in the right direction toward building economic justice.

15. Why do we need to protect the capital gains tax from efforts to repeal it?

The tax invests in kids, families, teachers, child care workers, and our communities. With the funding it generates, more families will have access to affordable preschool and child care. Further, early learning and child care educators who care for our future generations will be adequately compensated. Enacting this tax on the wealthiest households to invest in and prioritize community needs was a vital call-to-action. As the economic fallout of the pandemic persists, this critical resource must be protected.







Endnotes

1. See IRS publication 544 (p.22) for a list of capital assets that could result in taxable capital gain when sold, <https://www.irs.gov/pub/irs-pdf/p544.pdf>
2. Washington State Budget & Policy Center calculations of data from the Washington State Department of Revenue. <https://budgetandpolicy.org/wp-content/uploads/2022/06/2022-Statewide-data-fact-sheet-1.pdf>
3. Budget & Policy Center; data from the Washington State Department of Revenue, "Capital Gains Return Counts and Net Tax Stratified on County or Region for Tax year 2022 – ESSB 5096 as passed the legislature," May 27, 2021.
4. Budget & Policy Center, Seattle's millionaires would profit most if schools lose funding from capital gains tax.
5. Washington State Department of Revenue, Local Sales & Use Tax Rates, 2022, Quarter 1. https://dor.wa.gov/sites/default/files/2022-02/LSUFlyer_22_Q1.pdf?uid=62a8a55f1951d. There is no taxing district with a combined state and local tax rate less than 7%. One taxing district, the unincorporated areas of Klickitat County, has a combined sales tax rate of 7%.
6. Budget & Policy Center, New reforms bring balance and equity to state's tax code and economy
7. Engrossed Substitute Senate Bill 5096, Sections 1 and 2. <https://lawfilesexternal.wa.gov/biennium/2021-22/Pdf/Bills/Session%20Laws/Senate/5096-5.SL.pdf?q=20220714173037>
8. Engrossed Substitute Senate Bill 5096, Section 7. [full bill link in endnote 7]
9. Engrossed Substitute Senate Bill 5096, Section 9. [full bill link in endnote 7]
10. Engrossed Substitute Senate Bill 5096, Section 6. [full bill link in endnote 7]
11. Ibid.
12. Engrossed Substitute Senate Bill 5096, Sections 6 and 8. [full bill link in endnote 7]
13. See Publication 559, from the IRS, https://www.irs.gov/publications/p544#en_US_2013_publink100072611
14. Federation of Tax Administrators, https://www.taxadmin.org/assets/docs/Research/Rates/ind_inc.pdf. Idaho's capital gains tax rate decreased to lower than 7%, where it now sits at 6.5%.

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