

Why do we need a capital gains tax?

FREQUENTLY ASKED QUESTIONS

In 2021, Washington state lawmakers listened to the calls of community advocates to pass a state capital gains excise tax on the extraordinary profits people make on the sale of high-end stocks and bonds. This commonsense tax, which went into effect in 2023, better ensures that ultra-wealthy people pay what they owe in taxes, makes our state tax code more equitable, and provides critical funding to schools and child care. In its first year alone, the capital gains tax generated nearly \$900 million in revenue.¹ The revenue from the tax supports the Fair Start for Kids Act, making child care more affordable and accessible to people with young children, and it supports much-needed school construction projects and basic education for schools across Washington state. We have some answers to frequently asked questions about the capital gains tax.

What the capital gains excise tax is:

1. What are capital gains?

Capital gains are profits people receive from the sale of corporate stocks, bonds, and other high-end financial assets.³

2. What is the Washington state capital gains tax rate?

The tax rate is 7% of the profits received from the sale of certain capital gains. That's less than the combined state and local sales tax rate people in Washington pay when they buy clothes, toiletries, and other common household goods – which in some localities reaches 10.6%.⁴ Washington's capital gains excise tax only applies to profits over \$250,000⁵ per year from some types of capital gains (profits from real estate, sales of small businesses, and retirement accounts, for example, are specifically excluded).

Prior to implementation of the capital gains tax, millionaires paid nothing in state taxes when reaping huge profits from the sale of high-end financial assets. The capital gains tax helps to correct that fundamental imbalance in our state's tax code.

WHY KEEP THE CAPITAL GAINS TAX IN PLACE?

The capital gains tax invests in kids, families, teachers, child-care workers, and our communities. The funding generated by the tax means more families have access to affordable preschool and child care. Further, the tax revenue ensures early learning and child-care educators who care for future generations can be adequately compensated. It also pays for improvements to school buildings and construction projects.²

3. 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. State law clearly outlines and structures this tax as a capital gains excise tax. In March of 2023, the Washington State Supreme Court overwhelmingly ruled that this was a legally valid excise tax.⁶

The tax is applied in the event of a sale of stocks or other financial assets that result in substantial profit. 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.

Who is affected by the capital gains tax:

4. Who pays the Washington state capital gains tax?

The capital gains tax is almost exclusively paid by 0.2% of the wealthiest Washingtonians in the state – those with average incomes of more than \$2 million per year.⁷ In its first year of implementation, fewer than 4,000 households paid the excise tax.

The top 1% of earners in Washington, or households with incomes above \$878,400 annually, have experienced an average tax increase of less than 1% since implementation of the capital gains excise tax.⁸ In addition, 84% of the tax collected in the first year was paid by wealthy households in King County.⁹

99.8%
of taxpayers in our
state don't pay
Washington's
capital gains tax.

5. Do other states have capital gains taxes?

Yes. Forty-two other states and the District of Columbia tax capital gains. Ten 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%).¹⁰

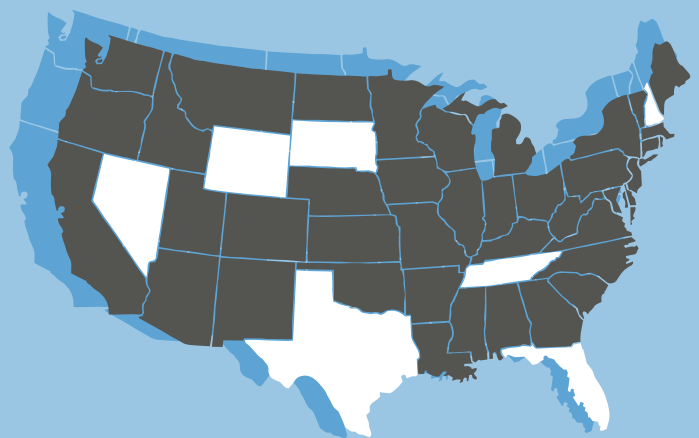
MOST STATES ALREADY TAX CAPITAL GAINS

States that tax
capital gains

42

States that don't
Tax capital gains

8



What the capital gains tax means for our economy:

6. Is the capital gains tax a stable source of funding?

Capital gains taxes are expected to fluctuate year to year based on changes in the economy. That's why this tax is smartly designed with the first \$500 million going to ongoing spending commitments associated with the Fair Start for Kids Act, and any revenue over that amount going to one-time expenditures related to school construction. Washington state's overall tax revenue from sales and property taxes is also stable, so any fluctuations from the capital gains tax can be easily managed.

7. Is the capital gains excise tax good for Washington's economy?

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

WHO SUPPORTS THE CAPITAL GAINS TAX?

Advocates, teachers, students, economic and racial justice organizations, and many other activists and community leaders called for the passage of an excise tax on capital gains in Washington for many years because they wanted better community investments and fixes to our unjust tax code – in which low- and middle-income families pay a higher rate in state and local taxes than the wealthiest 1%.

The capital gains tax passed during the 2021 legislative session because legislators, organizers, and advocates came together to make the tax code more equitable and invest in our communities to address the economic crisis brought about by the COVID-19 pandemic. **The passage of the tax in 2021 was a historic victory for economic justice.** In fact, thanks to the implementation of the capital gains tax and the Working Families Tax Credit in 2023, our state no longer has the most inequitable tax code in the nation.

Where the money goes:

8. How much revenue has the tax generated and how are those funds spent?

In its first year, the tax generated nearly \$900 million in revenue.¹¹ Under the law, the first \$500 million in annual state capital gains tax revenue is dedicated to K-12 school operations as well as 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.¹²

In 2021, advocates pushed legislators to pass the Fair Start for Kids Act, which ensures that children across Washington have accessible, affordable, high-quality child care and early learning support, regardless of their family's income.¹³ The funding for the act is made possible by the revenues from the capital gains excise tax.

What the capital gains tax applies to:

9. Does the excise tax on capital gains 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.¹⁴ As described in more detail in the following questions, other common assets held by people in Washington are also exempt from taxation.

10. Does the capital gains tax apply to small businesses and small farms?

No. The tax only applies to ultra-wealthy 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 exempt from the state capital gains tax.¹⁵

11. Do people owe any capital gains taxes on stocks that are donated to charity?

No. Gifts of stock or other assets to a charity or nonprofit are not subject to federal capital gains taxes nor the Washington state capital gains tax. In fact, Washington taxpayers can deduct up to \$105,000 in contributions to charity from any qualified source.¹⁶

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

No. The tax does 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 Internal Revenue Service for federal tax purposes. Nor would the tax apply when funds from those plans are drawn down during retirement.¹⁷

13. If a person sells their home, do 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 such as houses, condominiums, residential houseboats, duplexes and triplexes, and non-corporate-owned investment properties from the tax.¹⁸

THE TAX DOES NOT APPLY TO THESE COMMON INVESTMENTS:



SMALL
BUSINESSES



FARMLAND
& EQUIPMENT



TIMBER



RETIREMENT
PLANS



FAMILY
HOMES



DONATIONS
TO CHARITY



COLLEGE
SAVINGS

Endnotes

1. Washington State Department of Revenue, Capital gains excise tax generates \$896 for education, school construction, 2024, <https://dor.wa.gov/about/news-releases/2024/capital-gains-excise-tax-generates-896-million-education-school-construction>
2. The Seattle Times, Why school districts across the states are slashing their budgets, 2023, <https://www.seattletimes.com/education-lab/why-schools-across-the-state-are-slashing-their-budgets/>
3. See IRS publication 544 (p.29) for a list of capital assets that could results in taxable capital gain when sold, <https://www.irs.gov/pub/irs-pdf/p544.pdf>
4. Washington State Department of Revenue, Local Sales & Use Tax Rates, 2024, Quarter 2. https://dor.wa.gov/sites/default/files/2024-02/Q224_LSU_flyer.pdf. There is no taxing district with a combined state and local tax rate less than 7%.
5. The capital gains excise tax standard deduction updates to account for inflation each year. In tax year 2023, according to the Department of Revenue, the standard deduction amount was \$262,000.
6. Washington State Department of Revenue, Capital gains excise tax ruled constitutional, 2023. <https://dor.wa.gov/about/news-releases/2023/capital-gains-excise-tax-ruled-constitutional>
7. Washington State Department of Revenue, Net capital gains tax payments, 2024, <https://dor.wa.gov/taxes-rates/other-taxes/capital-gains-tax/net-capital-gains-tax-payments>
8. Washington State Budget and 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.
9. Washington State Department of Revenue, Net capital gains tax payments, 2024, <https://dor.wa.gov/taxes-rates/other-taxes/capital-gains-tax/net-capital-gains-tax-payments>
10. Center on Budget and Policy Priorities, "Capital Gains Question," Washington State Budget and Policy Center information request, received on Apr. 22, 2024, on file with author.
11. Washington State Department of Revenue, Capital gains excise tax generates \$896 for education, school construction, 2024, <https://dor.wa.gov/about/news-releases/2024/capital-gains-excise-tax-generates-896-million-education-school-construction>
12. Engrossed Substitute Senate Bill 5096, Sections 1 and 2. <https://lawfilesexternal.wa.gov/biennium/2021-22/Pdf/Bills/Session%20Laws/Senate/5096-S.SL.pdf?q=20220714173037>
13. Washington State Department of Children, Youth, and Families, Fair Start for Kids Act. <https://www.dcyf.wa.gov/about/government-affairs/fair-start-for-kids-act>
14. Washington State Department of Revenue, capital gains tax, <https://dor.wa.gov/taxes-rates/other-taxes/capital-gains-tax>. Note: The capital gains excise tax standard deduction updates to account for inflation each year. In tax year 2023, according to the DOR, the standard deduction amount was \$262,000.
15. Engrossed Substitute Senate Bill 5096, Sections 6 and 8. <https://lawfilesexternal.wa.gov/biennium/2021-22/Pdf/Bills/Session%20Laws/Senate/5096-S.SL.pdf?q=20220714173037>
16. Id. (Note: The capital gains excise tax cap on amount of charitable donation deduction updates with inflation each year. In tax year 2023, according to the Department of Revenue, the standard deduction amount was \$105,000.)
17. Engrossed Substitute Senate Bill 5096, Section 6. <https://lawfilesexternal.wa.gov/biennium/2021-22/Pdf/Bills/Session%20Laws/Senate/5096-S.SL.pdf?q=20220714173037>
18. Id.

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