

Department of Revenue Fiscal Note

Bill Number: 5096 SB	Title: Capital gains tax	Agency: 140-Department of Revenue
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Part I: Estimates

No Fiscal Impact

Estimated Cash Receipts to:

Account	FY 2022	FY 2023	2021-23	2023-25	2025-27
GF-STATE-State 00 - 00 -		1,287,000,000	1,287,000,000	2,774,000,000	2,945,000,000
GF-STATE-State 01 - Taxes 05 - Bus and Occup Tax		(160,000,000)	(160,000,000)	(344,000,000)	(366,000,000)
Total \$		1,127,000,000	1,127,000,000	2,430,000,000	2,579,000,000

Estimated Expenditures from:

Account	FY 2022	FY 2023	2021-23	2023-25	2025-27
FTE Staff Years	13.7	37.2	25.5	30.7	33.0
GF-STATE-State 001-1	2,372,200	5,576,800	7,949,000	8,983,800	7,182,500
Total \$	2,372,200	5,576,800	7,949,000	8,983,800	7,182,500

Estimated Capital Budget Impact:

NONE

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

- If fiscal impact is greater than \$50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.
- If fiscal impact is less than \$50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).
- Capital budget impact, complete Part IV.
- Requires new rule making, complete Part V.

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Agency Approval: Don Gutmann	Phone: 360-534-1510	Date: 01/12/2021
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Request # 5096-1-1

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

CURRENT LAW:

There is no capital gains tax in Washington State.

PROPOSAL:

Beginning January 1, 2022, this bill would impose a tax on all individuals for the privilege of selling or exchanging long-term capital assets. The taxable amount is an individual's Washington capital gains. The tax rate is 9 percent.

After exempting certain capital gains based on the type of asset sold or exchanged, a standard exemption is available in the amount of:

- \$25,000 for single filers; and
- \$50,000 for joint filers.

WASHINGTON CAPITAL GAINS

The amount of Washington capital gains is computed by making certain adjustments to an individual's federal long-term net capital gains. Only capital gains sourced to Washington are taxed. Losses resulting from the sale or exchange of long-term capital assets sourced elsewhere (such as from the sale of real property located in another state) may not be used to reduce the amount of taxable Washington capital gains.

EXEMPTIONS BASED ON TYPE OF ASSET SOLD OR EXCHANGED

The capital gains tax does not apply to the following:

- Capital gains exempted from the federal income tax, such as (1) from the sale or exchange of a primary residence or (2) received from certain retirement accounts.
- The sale or exchange of any residential dwelling, along with the land upon which the dwelling is located.
- The sale or exchange of assets under most retirement savings vehicles.
- The sale or exchange of assets subject to eminent domain, or sold or exchanged under imminent threat of eminent domain.
- The sale or exchange of cattle, horses, or breeding livestock held for more than 12 months by farmers if more than 50 percent of the taxpayer's gross income is from farming or ranching.
- The sale or exchange of agricultural land or timberland by an individual meeting certain requirements.
- The sale or exchange of depreciable property used in a business, to the extent it qualifies for a deduction under Internal Revenue Code sections 167 or 179.
- The sale or exchange of timber or timberland, or the receipt of Washington capital gains as dividends and distributions from real estate investment trusts derived from gains from the sale or exchange of timber or timberland.

DEDUCTIONS

- A sole proprietor may deduct capital gains associated with the sale or exchange of assets used only for business purposes, to the extent gains from sales do not exceed the sole proprietor's net income for federal income tax purposes, or reduce their Washington capital gains below zero.
- A statutory deduction is provided for amounts that the state is prohibited from taxing under federal law or the constitutions of the United States or state of Washington.

CREDITS

B&O credit: A credit against the business and occupation (B&O) tax is allowed, to avoid taxing the same amounts under both the B&O and capital gains taxes.

Out-of-state credit: A credit against the capital gains tax is allowed for the amount of capital gains taxes paid to another taxing jurisdiction on capital gains derived from sources within the other taxing jurisdiction to the extent the capital gains are included in the measure of the Washington capital gains tax.

FILING DEADLINES

Washington capital gains tax returns and payments are due at the same time that the taxpayer's federal income tax return for the taxable year is due. The first capital gains tax return would be due on or about April 17, 2023. Individuals receiving a federal tax filing extension also qualify for a state capital gains tax filing extension, but the tax is still due on the original filing date.

Revenues will be deposited to the State General Fund.

EFFECTIVE DATE: This bill contains an emergency clause and takes effect immediately upon the Governor's approval.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

ASSUMPTIONS:

- Approximately 58,000 taxpayers pay capital gains taxes for taxes due in 2023.
- The tax takes effect on January 1, 2022, and the first payments are due on or about April 17, 2023.
- Because we do not have federal tax return data on nonresident individuals, this fiscal note assumes that the long-term net capital gains reported on Washington residents' federal tax returns is equivalent to the Washington capital gains for all taxpayers, including nonresidents.
- Decoupling the Federal Opportunity Zone program from the Washington capital gains tax will have a minimal but positive impact on revenues.
- No estimated payments or withholdings are made during the year.
- Compliance is 90 percent in the first year and 95 percent thereafter.
- Sole proprietor deduction:
 - Capital gains result from sole proprietor activities if at least 40 percent of a single taxpayer's AGI consisted of net profits from federal tax return forms Schedule C and Schedule F.
 - The amount of the sole proprietor deduction is capped at the amount of total net profits from Sch. C or Sch. F for federal income tax purposes.
 - Single-member LLCs, which are not considered sole proprietors for the purpose of the deduction, may report income on Sch. C and Sch. F. But for the purpose of the fiscal note, we assume that all individuals with net profits from Sch. C and Sch. F qualify for the deduction.
- B&O credit:
 - Each taxpayer maximizes the amount of the credit by applying the standard exemption (\$25,000 for single filers / \$50,000 for joint filers) first to gains realized from personal sources, applying any remainder to gains from business sources.
 - 10 percent of taxable capital gains resulting from business activity in the finance sector is not subject to the B&O tax, because it comes from private equity firms and hedge funds, which qualify for the investment income deduction against the B&O tax.
- The Financial Institutions Surtax for the B&O tax remains in effect.
- Future amounts of capital gains for Washington taxpayers equal the amounts reported in 2018 tax returns, adjusted by using forecasted rates of growth and decay.
- The ratio of the out-of-state credit to gross tax is the same for tax years 2017 and 2018.

DATA SOURCES:

- Internal Revenue Service (IRS) - Individual income tax returns data, tax years 2017 and 2018.
- IRS: SOI Tax Stats - Sales of Capital Assets Report on Individual Tax Returns, Tables 2A and 1C, Tax Years 2008 to 2012
- IRS: SOI Tax Stats - Partnership Statistics by Sector or Industry, Table 5, Tax Year 2016
- IRS: SOI Tax Stats - S Corporation Statistics, Table 6.1 and Table 7, Tax Year 2014

Request # 5096-1-1

- Department of Revenue: Excise tax data, CY2020, Q2, used to estimate effective B&O tax rates for financial sector firms.
- Department of Revenue: Excise tax data, CY2018, used to estimate percentage of gross revenues that come from small businesses.
- Personal Income Forecast (November 2020) at E0242-1 (2021). This includes the U.S. Congressional Budget Office: Capital gains realizations forecast (all states), August 2020, used to grow capital gains amounts.
- E0071-2 (2021) 9% capital gains tax, \$25k/\$50k deduction: We used the out-of-state adjustment factors from this estimate.

STATE GOVERNMENT (CASH BASIS, \$000):

FY 2022 -	\$ 0
FY 2023 -	\$ 1,127,422
FY 2024 -	\$ 1,200,626
FY 2025 -	\$ 1,228,625
FY 2026 -	\$ 1,268,775
FY 2027 -	\$ 1,311,634

LOCAL GOVERNMENT (CASH BASIS, \$000): None.

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

ASSUMPTIONS:

- This estimate affects 58,000 taxpayers.
- Taxpayers will not be required to make estimated payments.

FIRST YEAR COSTS:

The Department will incur total costs of \$2,372,200 in Fiscal Year 2022. These costs include:

Labor Costs - Time and effort equates to 13.74 FTEs.

- Provide technical advice, interpretation and analysis during the implementation process.
- Program, setup, test and verify computer systems to accept taxpayer returns and other required information and process reporting information for collection, audit, and refund purposes.
 - Develop training for processing and working with capital gains tax returns.
 - Answer phone calls and counter inquiries on tax questions and tax return preparation from businesses, individuals, and accountants.
 - Update and maintain hard copy and online educational and informational materials.
 - Create a special notice and update website and published information.
 - Respond to letter ruling requests and email inquiries.
 - Hear additional administrative reviews.
 - Adopt two new administrative rules.

Object Costs - \$624,600.

- Contract computer system programming.
- Purchase additional server equipment.
- Print and mail a special notice to affected taxpayers.
- Print and mail outreach materials, general correspondence, notices and returns to paper filers.
- Legal assistance from the Office of the Attorney General.

SECOND YEAR COSTS:

The Department will incur total costs of \$5,576,800 in Fiscal Year 2023. These costs include:

Labor Costs - Time and effort equates to 37.2 FTEs.

- Provide technical advice and interpretation services.
- Ongoing programming and testing of computer systems.
- Ongoing training development and training for the new tax.
- Create returns and design and develop new templates and forms.
- Answer phone calls and counter inquiries on tax questions and tax return preparation from individuals and accountants.
- Update and maintain hard copy and online educational and informational materials.
- Respond to letter ruling requests and email inquiries.
- Establish new reporting accounts for capital gains taxpayers.
- Process paper returns and associated work items.
- Resolve error and out of balance returns, conduct desk audits, prepare refunds and assessments.
- Collect delinquent assessments as a result of return errors.
- Hear additional administrative reviews.

Object Costs - \$1,927,800.

- Contract computer system programming.
- Purchase additional server equipment.
- Purchase additional scanning equipment.
- Acquire additional seat licenses for the Telephone Information Center.
- Print and mail outreach materials, general correspondence, notices and returns to paper filers.
- Acquire informational brochures.
- Background checks for employees working with Internal Revenue Service data.
- Legal assistance from the Office of the Attorney General.

THIRD YEAR COSTS:

The Department will incur total costs of \$4,654,000 in Fiscal Year 2024. These costs include:

Labor Costs - Time and effort equates to 27.1 FTEs.

- Provide technical advice and interpretation services.
- Ongoing programming and testing of computer systems including receiving and processing Internal Revenue Service information for verification of reporting and tax discovery.
- Ongoing training for the new tax.
- Answer phone calls and counter inquiries on tax questions and tax return preparation from businesses, individuals, and accountants.
- Update and maintain hard copy and online educational and informational materials.
- Respond to letter ruling requests and email inquiries.
- Establish new reporting accounts for capital gains taxpayers.
- Process returns, payments and all associated work items, including issuing assessments for return errors and underpayments.
- Assist taxpayers with reporting questions and respond to inquiries via email, web message, and paper correspondence.
- Collect delinquent assessments as a result of return errors.
- Hear additional administrative reviews.

Object Costs - \$2,131,100.

- Contract computer system programming.
- Purchase additional server equipment.
- Print and mail outreach materials, general correspondence, notices and returns to paper filers.
- Acquire informational brochures.
- Background checks for employees working with Internal Revenue Service data.
- Warrant filing fees and postage for collection of additional delinquent accounts.
- Legal assistance from the Office of the Attorney General.

FOURTH YEAR COSTS:

The Department will incur total costs of \$4,329,800 in Fiscal Year 2025. These costs include:

Labor Costs - Time and effort equates to 34.3 FTEs.

- Provide technical advice and interpretation services.
- Ongoing programming and testing of computer systems.
- Ongoing training for the new tax.
- Answer phone calls and counter inquiries on tax questions and tax return preparation from businesses, individuals, and accountants.
- Update and maintain hard copy and online educational and informational materials.
- Respond to letter ruling requests and email inquiries.
- Establish new reporting accounts for capital gains taxpayers.
- Process returns, payments and all associated work items, including issuing assessments for return errors and underpayments.
- Assist taxpayers with reporting questions and respond to inquiries via email, web message, and paper correspondence.
- Create a tax discovery process and use desk audits to assess discovered liabilities.
- Collect delinquent assessments as a result of return errors.
- Hear additional administrative reviews.

Object Costs - \$1,089,800.

- Contract computer system programming.
- Purchase additional server equipment.
- Print and mail outreach materials, general correspondence, notices and returns to paper filers.
- Acquire informational brochures.
- Warrant filing fees and postage for collection of additional delinquent accounts.
- Background checks for employees working with Internal Revenue Service data.
- Utilize locate and research services to verify reporting and tax discovery.
- Legal assistance from the Office of the Attorney General.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2022	FY 2023	2021-23	2023-25	2025-27
FTE Staff Years	13.7	37.2	25.5	30.7	33.0
A-Salaries and Wages	1,085,200	2,204,000	3,289,200	3,628,400	3,832,000
B-Employee Benefits	390,500	793,400	1,183,900	1,306,300	1,379,600
C-Professional Service Contracts	500,000	1,500,000	2,000,000	3,000,000	1,000,000
E-Goods and Other Services	260,100	727,700	987,800	901,600	878,000
G-Travel	300	1,300	1,600	2,000	2,000
J-Capital Outlays	136,100	350,400	486,500	145,500	90,900
Total \$	\$2,372,200	\$5,576,800	\$7,949,000	\$8,983,800	\$7,182,500

III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	Salary	FY 2022	FY 2023	2021-23	2023-25	2025-27
ADM ASST 3	43,392		0.1	0.1	0.1	0.1
COMMUNICATIONS CNSLT 4	64,332	0.5		0.3		
CUSTOMER SERV SP2	39,528		1.9	1.0	0.6	0.6
CUSTOMER SERV SP3	42,420		1.0	0.5	0.1	0.1
EMS BAND 4	119,061	0.0		0.0		
EMS BAND 5	139,090	0.0		0.0		
EXCISE TAX EX 1	43,392		2.0	1.0	2.0	2.0
EXCISE TAX EX 2	54,108		1.0	0.5	5.5	10.0
EXCISE TAX EX 3	59,688	1.0	1.3	1.2	1.5	2.0
EXCISE TAX EX 4	65,928		1.0	0.5	1.0	1.0
FISCAL ANALYST 3	55,524		0.1	0.1	0.1	0.1
FORMS AND RECORDS ANALYST 1						
IT APP DEV-JOURNEY	85,644	1.0	1.0	1.0	0.5	0.5
IT B A-JOURNEY	85,644	0.5	0.5	0.5	0.3	0.3
IT PROJ MGT-JOURNEY	89,916	1.0	1.0	1.0	0.5	0.5
IT QA-JOURNEY	85,644	1.5	1.5	1.5	0.8	0.8
MGMT ANALYST4	70,956	2.8	3.8	3.3	2.4	1.7
MGMT ANALYST5	78,408	0.6	0.6	0.6	0.2	0.1
OFF ASST 3	37,728		0.3	0.2	0.3	0.3
RECORDS MGMT SUPV	67,560		0.2	0.1		
REVENUE AGENT 4	64,332		1.0	0.5	1.0	1.0
TAX INFO SPEC 1	43,392		10.0	5.0	6.0	5.0
TAX INFO SPEC 2	46,644		2.0	1.0	2.0	2.0
TAX INFO SPEC 3	56,856		1.0	0.5	1.0	1.0
TAX INFO SPEC 4	64,332	0.5	2.0	1.3	1.0	0.5
TAX POLICY SP 2	72,756	0.0		0.0	0.1	0.1
TAX POLICY SP 3	82,344	2.6	2.3	2.5	2.2	1.9
TAX POLICY SP 4	88,644	0.5	0.5	0.5	0.5	0.3
WMS BAND 2	89,018	1.1	1.0	1.1	1.0	1.0
WMS BAND 3	101,257	0.0		0.0		
Total FTEs		13.7	37.2	25.5	30.7	33.0

III. C - Expenditures By Program (optional)

NONE

Part IV: Capital Budget Impact

IV. A - Capital Budget Expenditures

NONE

IV. B - Expenditures by Object Or Purpose

NONE

IV. C - Capital Budget Breakout

Identify acquisition and construction costs not reflected elsewhere on the fiscal note and describe potential financing methods

NONE

None.

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

Should this legislation become law, the Department will adopt two new rules under Chapter 458-20 WAC, one using the complex process and one using the standard process. Persons affected by this rule making would include Individuals meeting the threshold for reporting and/or paying the new capital gains tax.