

COURTS LIFT STAY ON WASHINGTON STATE NEW CAPITAL GAINS TAX.

The Washington State Supreme Court has cleared the way for the state to collect certain capital-gains taxes from individuals. And the reporting of the capital-gains taxes will be required for the 2022 tax year filings (filed by April 15, 2023). The WA State Supreme Court is still considering the legality of this tax, with the central issue for the court: Is the capital gains tax an income tax or an excise tax? As with most other states – and confirmed by IRS rulings, capital gains are recognized as *income*. But WA State classifies *income* as property. And due to strict WA State constitutional restrictions on collecting property taxes, this disallows any form of *income* tax collection. Arguments are still to be heard by the WA State Supreme Court, and a decision will not be forthcoming until sometime in the Spring of 2023. Even though the decision is yet to come, this lifting of the stay now allows WA State to collect this capital gains tax until the WA State Supreme Court says otherwise.

A brief explanation of this new tax for individuals.

- 1) With certain restrictions, the state is placing a 7% excise tax (“sales tax”) on the sale or exchange of stocks, bonds, and certain businesses starting Jan 1, 2022, through Dec 31, 2022 — the first tax of its type in state history. This excise tax only applies to gains allocated to WA State.
- 2) The tax applies to profits over \$250,000.00 in the calendar year- whether filing single or jointly.
- 3) Some of the more common assets exempt from this new excise tax are real estate transactions, depreciable business assets, a qualified family-owned small business & retirement accounts.

So how does this new tax affect the preparation and filing of your Federal Tax return and the new WA State Capital Gains “return”?

- 1) This new excise tax will need to be filed through the WA State Department of Revenue (DOR). Currently, the DOR is not set up with the ability to file these returns... no forms are set up, nor any easy method for individuals to create an account on their website.
- 2) This means, when RainCity CPA, PLLC is preparing your return to reflect this new excise tax, we believe we will have to hand fill out these forms (when available) as the tax programs we use for Federal and other non-WA State Income taxes will not be set up to accommodate a WA State individual excise tax.

- 3) How this excise tax reporting form, along with the client's Federal 1040 return (required attachment to the WA State filing), let alone any required payment(s) to be sent to the DOR, is not clear at this time.
- 4) How to treat DOR extension payments, estimated DOR tax payments, penalties, interest, etc. have also not yet been defined.

Major flags for certain capital gains transactions to be taxed or not taxed by WA State need clarification

- 1) It is unclear, at this time, if clients who receive company stock options as compensation will need to file these new DOR returns even though the transactions may result in a loss.
- 2) Pass-through entities that generate K1's may now have to define what comprises the income. Currently, K1's only provide a dollar figure, not a breakdown of what the dollar amount entails (capital gains are a line item on all K-1's but do not provide a detail of the actual transactions).
- 3) Although this tax is not assessed on real estate transactions, we believe that WA will tax any dollar amounts shown on the Federal Schedule D; the form used to report real estate transactions. So RainCity CPA, PLLC may need to file a zero due/"negative" return with the Department of Revenue to show that some or all of the amounts reported on the Schedule D to the IRS are either a real estate gain or otherwise not subject to this tax. We reference this as a "negative" return, which basically means "Yes, I have gains, but they are excludable gains and thus I owe no tax".
- 4) Unlike losses through the Federal Tax returns, there appears to be no allowance for the carry-over of losses. This is a stand-alone tax, meaning that each year is looked at individually, and the tax will be imposed on only the transactions for the one year in question.

As a reminder, this new 7% flat rate excise/capital gains tax applies to gains exceeding \$250,000. And we, as CPA's, are obligated to follow these new requirements and prepare and file the 2022 tax returns accordingly, despite so many of the rules and procedures left to be defined, or even approved by the WA State Supreme Court. Unfortunately, if we are required to prepare this new WA State tax form for qualifying gains, or a "negative" return to avoid WA State taxing on excludable gains, we will have to bill our clients for this additional work.

We ask for your patience as we navigate, what is surely to be the biggest change to WA State residents tax filing procedures ever. We will keep you abreast of all changes as this develops.

