

What Is Likely the Last Chapter in the Wild Journey of the Washington State Capital Gains Tax Occurred on November 5, 2024, With Voters Getting the Final Say

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The Wild Journey

I am taking time out from my multi-part series on Subchapter S to report on the Washington capital gains tax. As you know, I have reported in [several prior blog posts](#) on the numerous challenges confronting the tax. The long, interesting and turbulent ride of this legislation, however, may be over!

Initiative 2109 was presented to Washington state voters. A "yes" vote for the initiative would repeal the new tax, while a "no" vote would retain the new tax.

On November 5, 2024, the voters spoke loud and clear - they overwhelmingly voted to retain the Washington capital gains tax. A whopping 64.1 percent of the voters (2,341,553 voters) voted "no" on the initiative, while 35.9 percent of the voters (1,312,162 voters) voted "yes."

The Washington capital gains tax is clearly a resilient creature of statute. Its journey is encapsulated as follows:

- It barely passed the Washington legislative process.
- It was immediately attacked with a lawsuit to end its life before Governor Jay Inslee could even sign the legislation into law.
- Judge Brian C. Huber of the Superior Court of Washington for Douglas County ended the lawsuit, striking down the tax as unconstitutional.
- A few weeks later, Washington Attorney General, Robert W. Ferguson, appealed the court decision.
- On March 24, 2023, after briefing and oral argument, the Washington State Supreme Court, in a 7-2 decision, overturned the Douglas County court, declaring the tax as constitutional.
- Opponents of the tax sought intervention by the U.S. Supreme Court.
- In January 2024, the high court denied the writ of certiorari.

- Opponents of the tax did not give up the fight. They decided to take the issue to the voters with a ballot initiative.
- Before the initiative could be presented to the voters, the state of Washington election officials declared that the ballot measure must include a disclosure of the revenue impact its passage would have on the state's revenue.
- A lawsuit ensued over the disclosure requirement.
- Judge Allyson Zipp of the Superior Court of Washington for Thurston County ultimately ruled that the ballot measure must fully disclose the fiscal impact of its passage.
- The last twist in the journey of the tax occurred on November 5, 2024, when voters of Washington finally got the opportunity to voice their opinion. As stated above, Initiative 2109 was overwhelmingly rejected by the voters, leaving the Washington capital gains tax intact.

Absent a future voter initiative or legislative action to repeal the tax, it appears that the Washington capital gains tax is here to stay. Consequently, taxpayers expecting an event that will result in Washington capital gains need to familiarize themselves with the tax and its many carve-outs. Accordingly, a brief primer relative to the Washington capital gains tax is warranted. The following primer provides a broad overview of the tax regime. There are plenty of nuances in the law that require a thorough reading of the statute and the administrative rules adopted by the Washington Department of Revenue.

Overview of the Washington Capital Gains Tax

The new law went into effect on January 1, 2022. The tax is seven (7) percent on the long-term capital gains derived from the voluntary sale or exchange of stocks, bonds and other capital assets in excess of \$250,000 per year (subject to an inflationary adjustment). For this purpose, the law defines “capital assets” by adopting the definition contained in Section 1221 of the Internal Revenue Code of 1986, as amended. Long-term capital gains result from the sale or exchange of a long-term capital asset (a capital asset held more than one year). The law contains numerous notable exceptions. The tax does **not** apply to:

- Any real estate transferred by deed, contract, judgment or other lawful instrument.
- Any (direct) interest in a privately held entity but only to the extent that the long-term capital gain or loss from the sale or exchange is directly attributable to real estate directly owned by the entity.
- Retirement Accounts.
- Condemnations or transfers under the imminent threat of condemnation.
- Cattle, horses or breeding livestock provided more than half of the taxpayer's gross income during the taxable year is derived from farming or ranching.

- Depreciable property (i.e., property qualifying for expensing under Code Section 179 or depreciation under Code Section 167(a)(1)) used in a trade or business.
- Timber, timberland, dividends and distributions from REITs derived from the sale or exchange of timber or timberland.
- Commercial fishing privileges.
- Goodwill from the sale of an automobile dealership.

The “adjusted capital gain derived in the taxable year from the sale of substantially all of the fair market value of the assets of, or the transfer of substantially all of the taxpayer’s interest in, a qualified family-owned small business” is also **not** subject to the tax. There are several components to this carve-out:

- The business must be a “qualified family-owned business.”
- A “qualified family-owned business” is a business: (i) in which the taxpayer held a “qualifying interest” for at least five years immediately preceding the sale or exchange; (ii) the taxpayer or members of his/her family materially participated (or both) in the business for at least five of the ten years immediately preceding the sale or exchange (unless the sale or exchange was to a qualified heir); and (iii) the worldwide gross revenue of the business is \$10 million or less (subject to an inflationary adjustment) for the 12-month period immediately preceding the sale or change.
- “Qualifying interest” means (i) an interest as a sole proprietor; (ii) an interest of at least 50 percent of a business that is owned (directly or indirectly) by the taxpayer and/or members of his/her family; or (iii) an interest of at least 30 percent of a business that is owned (directly or indirectly) by the taxpayer and/or members of his/her family and at least 70 percent is owned (directly or indirectly) by two families or 90 percent is owned (directly or indirectly) by three families.
- For purposes of these requirements, “material participation” has the meaning prescribed by Code Section 469. In general, it means being involved in the business on a regular, continuous and substantial basis.
- “Qualified heir” means a member of the taxpayer’s family. In turn, “family” includes ancestors of the taxpayer, the spouse or state-registered domestic partner of the taxpayer; lineal descendants of the taxpayer, of the taxpayer’s spouse or state-registered domestic partner, or of a parent of the taxpayer; or the spouse or state-registered domestic partner of any lineal descendant of these individuals.
- “Substantially all” means 90 percent (applied in terms of value).

The law provides a deduction of up to \$100,000 from a taxpayer’s capital gains if the taxpayer made \$250,000 or more in contributions to a charity directed or managed in Washington during the same tax year as the sale or exchange giving rise to the tax.

To avoid double taxation on a sale or exchange of a capital asset under the Washington Business and Occupation (“B&O”) tax regime, a credit is allowed against taxes due under the B&O tax regime if such sale or exchange is also subject to the capital gains tax. In such cases, the credit is the amount of B&O tax incurred from the sale or exchange of the capital asset.

The law comes with some compliance teeth. In addition to civil penalties and interest for noncompliance, it is a Class C felony to knowingly attempt to evade the tax. Also, it is a gross misdemeanor for knowingly failing to pay the tax, file returns or keep records or supply the taxing authority with information requested relative to the tax.

Conclusion

Unless voters or the legislature repeal the Washington capital gains tax, it is here to stay.

Taxpayers and their advisers need to be aware of the tax regime and familiarize themselves with the statute and the administrative rules (as they are published by the Washington Department of Revenue). The cost of noncompliance may be significant.

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