

SENATE BILL REPORT

SB 6102

As of April 22, 2015

Title: An act relating to enacting an excise tax on capital gains to improve the fairness of Washington's tax system and provide funding for the education legacy trust account.

Brief Description: Enacting an excise tax on capital gains to improve the fairness of Washington's tax system and provide funding for the education legacy trust account.

Sponsors: Senators Ranker, Hargrove, Keiser, Chase, Kohl-Welles, McAuliffe, Hasegawa, Frockt, Nelson, Hatfield, Cleveland, Conway, Billig, Rolfes, McCoy, Jayapal, Fraser, Pedersen and Darneille.

Brief History:

Committee Activity: Ways & Means: 4/20/15.

SENATE COMMITTEE ON WAYS & MEANS

Staff: Juliana Roe (786-7438)

Background: A capital gains tax (CGT) is a tax on the profit realized on the sale of non-inventory assets that are purchased at a lower price than the sales price. The most common capital gains are realized from the sale of stocks, bonds, and real estate.

Under the federal tax code, individuals and corporations pay income tax on the net total of all their capital gains just as they do on other sorts of income. The amount of federal CGT depends on both the tax bracket of the individual and the amount of time the capital asset was held before being sold. Short-term capital gains are taxed at the individual's ordinary income tax rate, and are defined as capital assets held for a year or less before being sold. Currently, long-term capital gains are generally taxed at a preferential rate in comparison to ordinary income for federal income tax purposes. The long-term capital gains tax rates for 2014 are: 0 percent for taxpayers in the 10 percent or 15 percent marginal income tax brackets; 15 percent for taxpayers in the 25 percent, 28 percent, 33 percent, or 35 percent marginal income tax brackets; and 20 percent for taxpayers in the 39.6 percent top bracket.

In addition to the federal CGT, capital gains are often subject to state income taxes. Most states do not have separate capital gains tax rates. Instead, most states tax capital gains as ordinary income subject to the state's income taxes rate. Washington has neither an income tax nor any specific excise tax on capital gains.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Summary of Bill: Beginning January 1, 2016, an annual state net CGT is imposed on the sale or other voluntary exchange of capital assets, with some exceptions, by resident individuals during the year. The tax rate is 7 percent. The tax rate is applied to the capital gains amount reported on the federal income tax return. For resident individuals, all capital gains are apportioned to the state, regardless of the location of the asset. All revenues from the CGT must be deposited into the education legacy trust account to be spent on the program of basic education.

All taxpayers must file with the Department of Revenue (DOR), a CGT return for each taxable year; however a person with no tax liability is not required to file a tax return. The due date of the CGT is the due date for the federal income tax return, unless otherwise required by DOR. The first state CGT returns are due in 2017.

For taxpayers filing joint federal tax returns, a \$500,000 deduction is provided. For taxpayers filing other returns, a \$250,000 deduction is allowed. The CGT does not apply to the sale or exchange of residential real property; retirement accounts; cattle, horses or breeding livestock held for more than 12 months; agricultural or timber land; or timber.

Appropriation: None.

Fiscal Note: Requested on April 15, 2015.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed with implementation of the bill beginning January 1, 2016.

Staff Summary of Public Testimony: PRO: This bill is a great first step in addressing school needs. We need a modern, reliable, sustainable and fair revenue stream. The CGT contributes needed funding for educations, improves fairness and equity of the state tax system, and avoids negative impacts on business. A small number of taxpayers, who can afford this tax without economic hardship, are affected by this bill.

The CGT would make the state tax system more adequate and equitable while raising hundreds of millions of dollars. The CGT would only have a modest impact on the overall volatility of state taxes. While we should not fund the entire state budget with the CGT, it is a good funding source when combined with all other state taxes. Another way to address volatility would be to set aside a portion of the CGT revenue in some sort of rainy day fund. Higher earning Washingtonians who would be subject to the CGT would not leave the state and, therefore, the CGT will not harm the state economy. Research shows that taxes at most have a negligible impact as to where people to choose to locate, with housing costs, public services, and climate having a much greater impact on relocation choices.

CON: The CGT is a volatile source of revenue and should not be relied on for education funding. In 2007, Washington reported \$23.7 billion in CGT at the federal level. However, in 2009 Washington reported only \$5.8 billion. That is a substantial change from year to year proving that the CGT is volatile and further proof that historical averages of gains are not

predictable for future gains. Furthermore, Washington would be the first non-income tax state to have a CGT. It would also likely face many legal challenges to its constitutionality.

The CGT applies to small businesses. Property used in trade or business is depreciable property. Most small businesses try to develop a business with good will. The business has a customer base, reputation, and all operations to make it successful and many hope to sell the business upon retirement. In fact, 78 percent of small business owners plan to fund their retirement by the sale of their small businesses. The beneficial interest of the business would accrue to the business owner through the sale of the business. While there are some allowed exclusions of certain assets deducted, the bill would not allow a deduction for the sale of the real estate upon which the business sits. We should protect the sale of businesses from the CGT for the purpose of retirement.

While it appears as though the intent of the bill is to exempt timber and timberland, the bill does not quite accomplish this. Forest income, ordinary income from growing and harvesting timber, gets capital gains treatment at the federal level. Because timber takes many years between planting and harvesting - as much as 50 years - the tax at harvest is basically upon 50 years of inflation. Most often, timber harvest is a once in a lifetime event for people that usually comes at a time of need whether it be for college tuition, nursing home costs, or retirement. We hope that investment in timberland will not be adversely affected by the CGT.

This bill would hit people in the cattle industry particularly hard. Most ranchers don't hold their cattle for a year, generally just a few months. These are short-term gains which require payment of capital gains at the federal level.

The voters rejected a state income tax by crushing the initiative at the ballot box with a 64 percent no vote. We are seeing proposals that ignore the voter mandate. You may call it a CGT, but it's really an income tax. This is opening Pandora's box. If the bill passes, it will be morphed into a state income tax and will eventually be imposed on everyone. If the bill passes, the governor's budget office said that the 7 percent rate would generate \$5.6 billion dollars over the next ten years. That is a large tax increase. Successful people are not the enemy. They should be getting a pat on the shoulder and not a knife in the back. Voters do not support you stealing their earned achievements. Voters do not want new taxes.

Persons Testifying: PRO: Senator Ranker, prime sponsor; Shawn Lewis, WA Education Assn.; Nick Federici, WA United for Fair Revenue; Andy Nicholas, WA State Budget and Policy Center; Mitch Denning, Alliance of Educational Assns; Nancy Moffatt, WA Assn. of School Business Officers; Dan Steele, WA Assn. of School Administrators; Steven Aldrich, Friends Committee on WA Public Policy; Sherry Krainick, Washington State PTA.

CON: Patrick Connor, National Federation of Independent Business, WA State Director; Amber Carter, Assn. of WA Business; Gary Smith, Independent Business Assn.; Bob Mitchell, WA State Commercial Assn. of REALTORS, Commercial Brokers Assn.; Carolyn Logue, WA Food Industry Assn.; John Ehrenreich, WA Forest Protection Assn.; Heather Hanson, WA Farm Forestry Association; Denny Eliason, WA Restaurant Assn.; Jack Field, WA Cattlemen's Assn.; Tim Eyman citizen.

Persons Signed in to Testify But Not Testifying: No one.