



MULTISTATE TAX

Washington Department of Revenue to administer capital gains tax while state court case is pending

Tax Alert

Overview

In 2021, Washington State enacted [Senate Bill 5096](#) (“SB 5096”), which imposed a 7% tax on Washington long-term capital gains earned by individuals from the sale or exchange of certain capital assets beginning January 1, 2022. The bill characterized the tax as an excise tax. For more information on SB 5096, including the key details of the capital gains tax such as deductions and exemptions, please see this previously issued [Tax Alert](#).

In March 2022, a trial court judge held that this new tax was an income tax and therefore unconstitutional under the Washington State Constitution. The Washington Department of Revenue (“Department”) appealed to the Washington Supreme Court (“Court”). The Court granted the state’s motion to stay the trial court’s decision pending the Court’s final decision. As a result, the Department may now accept capital gains returns and collect taxes while the Supreme Court case is pending.

Background

After SB 5096 was enacted, a group of taxpayers challenged the capital gains tax. On March 1, 2022, the Washington Superior Court of Douglas County [ruled](#) in favor of the taxpayer group and held that the tax enacted by SB 5096 is an invalid income tax (rather than an excise tax) in violation of the Washington State Constitution. The Department appealed the lower court’s ruling to the state Supreme Court. Oral arguments are scheduled to begin on January 26, 2023.

Based on the lower court’s decision that SB 5096 is unconstitutional, the Department lacked the authority to collect the tax. As part of its appeal, the Department also filed a motion with the Court for a stay of the lower court’s order while the case is pending. The Court [granted the motion](#) to stay on November 30, 2022. As a result, the Department may now administer the capital gains tax by accepting returns and collecting tax until the Court renders its final decision.

Washington capital gains tax compliance requirements

Individuals who file and pay this capital gains tax have the following compliance requirements:

- Individuals owing Washington capital gains tax must file a return with the Department by the due date of the individual's federal income tax return (including extensions) in accordance with Rev. Code Wash. section 82.87.110(1)(a). Note that the tax must be paid by the original due date of the individual's federal income tax return. Rev. Code Wash. 82.87.110(3).
- Generally, individuals must file the return and pay the capital gains tax electronically. Rev. Code Wash. 82.87.110(b)(i), (3)(a).

Despite the pending litigation, the Department has also issued a [proposed regulation](#) to implement the excise tax on capital gains that reflects proper filing procedures and penalties related to the tax. The proposed rule has not yet been finalized.

Considerations

If the Court rules that the capital gains tax is unconstitutional, tax that has already been collected by the Department will be refunded with interest. Conversely, if the Court upholds the tax, taxpayers will be required to remit the tax and file returns for tax years beginning on or after January 1, 2022. The Department could also impose penalties and interest for any late filings.

It is unclear whether the capital gains tax is deductible for federal income tax purposes as a state and local tax under IRC section 164, which is limited to \$10,000 per year for individuals.

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