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GMS Flash Alert

2023-104 | May 17, 2023

United States - Washington Excise Tax on Capital Gains Is Constitutional and Valid

The Washington State Supreme Court has ruled that the newly-enacted excise tax on the sale or exchange of long-term capital assets is constitutional and valid.[1] The tax, which applies to Washington State residents, became effective from January 1, 2022, with the first payments being due on or before April 18, 2023.

Also, the Washington State Department of Revenue has recently issued new interim guidance on the allocation rules and clarified the meaning of "domicile" for capital gains tax purposes.

WHY THIS MATTERS

This is the first time Washington state has imposed (and had upheld) an individual tax filing requirement. While the new tax will not apply to all Washington individuals, provided the availability of various exemptions and a standard deduction of $250,000, those domiciled in Washington state will now need to be made aware of the new 7-percent tax on sales of long-term capital assets which may create additional compliance obligations.

Tax professionals assisting individuals based in Washington should also familiarize themselves with the new rules.

International assignment program managers may wish to consider the impact of these new rules on Washington-outbound and inbound assignees, who may be subject to the law, and determine whether their international assignment tax policies should be amended to account for this tax law change.

More Details – Tax, Filing, and Payments

A 7-percent tax is imposed on the sale or exchange of long-term capital assets including stocks, bonds, business interests, tangible assets, and other investments allocated to Washington state.[2]

Several assets are exempt from the tax, including but not limited to real estate and assets held within certain retirement accounts.[3]

A $250,000 standard deduction is available per year for each individual or married couple, regardless of whether they file jointly or separately. The standard deduction is adjusted annually for inflation.[4]

The capital gains tax return is only required to be filed by individuals who owe tax.[5]

The deadline for filing the capital gains tax return is the same as the individual's federal tax return.[6] Taxpayers with an approved extension of time to file their federal returns also receive an extension of time to file their capital gains tax returns provided they submit to the department, by the original due date, the extension confirmation number or other evidence confirming the federal extension.[7]

The extension does not extend the deadline for payment. Penalties and interest will apply to late-filed returns and payments.[8] Underpayment penalties also apply to those who have "Substantially underpaid" their capital gains tax liability, meaning they have paid less than 80 percent of the tax due and the underpayment is at least $1,000.[9]

To submit a capital gains tax return, make payment, or provide the Department with documentation confirming their federal extension, individuals should create a SecureAccess Washington (SAW) account online. For more information, please visit the following Department of Revenue website "Capital Gains - My DOR help."

Interim Guidelines Regarding Capital Gain Allocation and Washington Domicile

On April 27, 2023, the Washington State Department of Revenue issued interim guidance on the allocation rules and clarified the meaning of "domicile" for capital gains tax purposes.[10]

Generally, there are three instances where long-term capital gains or losses are allocated to Washington state and subject to the new tax.[11]

1. Long-term capital gains or losses derived from intangible personal property are allocated to Washington if the taxpayer was domiciled in the state at the time the sale or exchange occurred.

2. Long-term capital gains or losses from the sale or exchange of tangible personal property are allocated to Washington if the property was located in the state at the time of the sale or exchange.

3. Long-term capital gains or losses from the sale or exchange of tangible personal property are also allocated to Washington even though the property was not located in the state at the time of the sale or exchange if:

    a) the property was located in Washington at any time during the taxable year in which the sale or exchange occurred or the immediately preceding taxable year;

    b) the taxpayer was a resident at the time the sale or exchange occurred;[12] and

    c) the taxpayer is not subject to the payment of an income or excise tax legally imposed on the long-term capital gains or losses by another taxing jurisdiction.

The interim guidance also clarifies that the term "domicile" means "residence in fact," as well as the intent to make a place of residence one's permanent home. An individual may only have one domicile at any given time. To change domicile, an individual must be physically present at his new domicile with the intention of making it his permanent home. The Department provides the following non-exclusive list of factors which may be evaluated in order to determine an individual's domicile:[13]

- Length of time spent in a location;

- Expressed intent;

- Place of business, profession, or employment;
- Location of bank accounts;
- Residence and address for federal income and state tax purposes;
- Sites of personal and real property owned by the individual;
- State of motor vehicle and other personal property registration;
- State of motor vehicle driver’s license;
- Location of schools attended by children;
- State of voter registration;
- Location of professional or business licenses;
- Payment of in-state tuition as a Washington resident;
- Claiming Washington as a residence for obtaining a hunting or fishing license, eligibility to hold public office, or for judicial actions;
- Mailing address.

KPMG INSIGHTS

With the implementation of the new capital gains tax comes planning opportunities for Washington individuals and their tax advisers. Those who are planning to sell some of their assets may wish to consider whether a disposition of their long-term holdings will trigger a capital gains tax liability. It may be of benefit to limit the amount of long-term gains recognized annually in order to fall under the $250,000 standard deduction.

Individuals moving into or out of Washington state during the year may also benefit from timing the recognition of significant long-term gains to fall outside of their period of Washington domicile.

Additionally, those who are subject to the tax may wish to consider making estimated payments in order to mitigate underpayment penalties.

Pre-departure and/or on-arrival discussions with assignees inbound to Washington or outbound from Washington should include a brief discussion of the new rules.

FOOTNOTES:

1 Court opinion available at 1007698.pdf (wa.gov).

2 See RCW 82.87.040.

3 See RCW 82.87.050.

4 See RCW 82.87.060.

5 See RCW 82.87.110.

6 Ibid.

7 Ibid.

8 Ibid.

9 See RCW 82.32.090.

10 See "Interim statement regarding the definition of domicile for capital gains excise tax allocation purposes" at the Washington Department of Revenue website (April 27, 2023).

11 See RCW 82.87.100.

12 RCW 82.87.020 Defines "Resident" as any individual (i) who is domiciled in this state during the taxable year, unless the individual (A) maintained no permanent place of abode in this state during the entire taxable year, (B) maintained a permanent place of abode outside of this state during the entire taxable year, and (C) spent in the aggregate not more than 30 days of the taxable year in this state; or (ii) who is not domiciled in this state during the taxable year, but maintained a place of abode and was physically present in this state for more than 183 days during the taxable year.

13 See "Interim statement regarding the definition of domicile for capital gains excise tax allocation purposes" at the Washington Department of Revenue website.

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Contact us

For additional information or assistance, please contact your local GMS or People Services professional or the following professional with the KPMG International member firm in the United States:

Arlo Hart
Manager, Global Mobility Services
Tel. + 1-206-913-4664
ahart@kpmg.com

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