



On March 24, 2023, the Washington Supreme Court [upheld](#) the state [capital gains tax](#) as a constitutional excise tax. The decision overturns the Douglas County Superior Court's ruling that the tax is an unconstitutional tax on income. The court declined to address or overturn its earlier decisions, which held that an income tax is a tax on property that is invalid unless it meets the uniformity and rate limitations of the state constitution.

In this Update, we answer a few of the most pressing questions about the Washington capital gains tax.

When does the tax commence?

The tax applies to capital gains recognized on or after January 1, 2022; the tax on long-term capital gains recognized in 2022 is due on April 18, 2023. Returns must be filed electronically with the [Washington](#)

[Department of Revenue.](#)

What is the tax rate?

A flat tax rate of 7% applies to Washington residents' net federal long-term capital gain per calendar year in excess of the standard deduction and exemptions.

What is subject to the tax?

The tax applies to a Washington resident's net federal long-term capital gain per calendar year in excess of the standard deduction and is subject to certain exemptions. The tax does not apply to short-term capital gains, qualified dividends, tax-exempt interest, and other categories of income.

What deductions and exemptions apply to the tax?

A standard deduction of \$250,000 is available for each individual and married couple (a married couple shares a single \$250,000 standard deduction, or \$125,000 for each spouse). Spouses who file joint returns for federal purposes must also file jointly for purposes of the Washington capital gains tax, effectively sharing and dividing equally all gains and losses for the year, while spouses who file separate federal returns must also file separate Washington returns and will have their Washington capital gains tax liability determined separately.

Several categories of assets, some broad and some narrow, are also expressly exempt from the tax. These include real estate, interests in privately held entities to the extent the value is attributable to directly owned real estate, assets held in retirement accounts, assets subject to condemnation proceedings, certain livestock, certain business assets subject to depreciation or expensing, timber, commercial fishing privileges, and goodwill from the sale of certain auto dealerships.

Gain from the sale of certain family-owned small businesses (with less than \$10,000,000 in annual revenue) is deductible as well.

A modest charitable deduction is available. It applies only to the amount of contributions to Washington charities over \$250,000 during the same taxable year, and it is limited to \$100,000.

Who is subject to the tax?

Individuals who are legally domiciled in Washington are generally subject to the tax, and individuals who are not legally domiciled in Washington are generally not subject to the tax (unless they recognize gain on the sale of tangible personal property located in Washington).

The tax does not apply to corporations or other entities, but individuals to whom capital gains are allocated from pass-through entities such as partnerships and LLCs would be subject to tax on those allocated gains.

How does the tax apply to trusts?

Trusts that are taxed as nongrantor trusts would not be subject to the Washington capital gains tax, but Washington beneficiaries of nongrantor trusts who receive allocations of long-term capital gain may be subject to the tax on those allocations. Capital gains recognized by grantor trusts, of which the trust assets are treated as owned by the grantor for federal income tax purposes, and by nongrantor trusts that would be includable in the grantor's estate (sometimes called "incomplete gift nongrantor trusts"), would be allocated and taxable to the grantor.

How might Washington residents plan for the tax?

There are several planning developments that taxpayers might consider. Taxpayers might consider changing their residency status prior to the recognition of large long-term capital gains; establishing legal domicile in a different state would avoid Washington's capital gains tax on intangible assets. For example, if a Washington resident taxpayer establishes residency in another state on April 1 and subsequently sells business assets generating long-term capital gains on June 1, the gains generally would not be subject to Washington's capital gains tax. Similarly, nonresidents moving to Washington may consider recognizing gains prior to establishing residency in Washington.

Taxpayers may also smooth out their capital gains income stream over several years to utilize the full annual \$250,000 deduction each year when feasible, including through the use of charitable remainder unitrusts. Taxpayers may also choose to give assets with built-in gains to lower-income beneficiaries or to nongrantor trusts to minimize or avoid the tax.

Will the capital gains tax be expanded to tax other income?

A broad-based income tax would violate the state constitution under Washington Supreme Court precedents. The court specifically declined to reexamine its prior decisions holding that the uniformity and rate limitations of the state constitution apply to broad-based income taxes.

The Washington Supreme Court held that the capital gains tax was a valid excise tax (rather than an unconstitutional property or income tax) because it "relates to the exercise of rights in and to property" rather than being a tax on the ownership of property. The court distinguished the tax from "broad-based income taxes" that have been previously held unconstitutional: "[T]his tax specifically targets an activity long recognized as subject to excise taxation—the sale or exchange of property."

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