Interim statement regarding the capital gains excise tax and calculation of credit for taxes paid to another taxing jurisdiction

October 11, 2023

Purpose

This interim guidance statement explains the computation of the Washington capital gains excise tax credit for taxes paid in another taxing jurisdiction.

Examples in this interim guidance statement identify facts and then state a conclusion. These examples should be used only as a general guide. The tax results of other situations must be determined after a review of all facts and circumstances.

Background

Beginning January 1, 2022, Washington imposes a capital gains excise tax on the sale or exchange of long-term capital assets. [1] The tax equals 7% multiplied by an individual's Washington capital gains. Washington capital gains generally means the net long-term capital gain reportable by an individual for federal income tax purposes, with certain adjustments. [2]

An individual subject to tax on their long-term capital gain in both Washington and another taxing jurisdiction [3] may qualify for a tax credit that reduces their Washington capital gains excise tax liability. [4] Specifically, RCW 82.87.100(2) provides a credit against the Washington capital gains excise tax equal to the legally imposed income or excise tax the taxpayer paid in another taxing jurisdiction on capital gains derived from capital assets within the other jurisdiction.

The credit applies when a taxpayer’s long-term capital gain from a capital asset is included in the taxpayer’s Washington capital gains, the capital asset is located in a jurisdiction other than Washington, and the other jurisdiction also taxed the long-term capital gain from that capital asset. The credit may not exceed the total amount of Washington capital gains excise tax due, and there is no carryback or carryforward of any unused credits.

Entitlement to the credit requires the following:

(i) Another taxing jurisdiction legally imposed an income or excise tax on capital gain included in the taxpayer's Washington capital gains;
(ii) The taxpayer in fact paid the tax imposed by the other taxing jurisdiction before the taxpayer filed their Washington capital gains excise tax return on which the credit is claimed; and
(iii) The gain taxed by the other jurisdiction arose from the sale or exchange of a capital asset within the other taxing jurisdiction. [5]

Calculation of amount of tax paid to another taxing jurisdiction

The credit for tax paid in another jurisdiction cannot exceed the amount of legally imposed tax you, in fact, paid to another other taxing jurisdiction on long-term capital gain included in your Washington capital gains. If the other taxing jurisdiction taxes the long-term capital gain along with other types of income, you should [6] calculate the amount of tax you paid to the other jurisdiction on the capital gain on a proportional basis as follows:

1. Determine the net tax you paid in the other taxing jurisdiction. Net tax means your tax liability in the other state after all tax credits.
2. If your tax liability in the other taxing jurisdiction is reduced to reflect tax paid to that jurisdiction by a pass-through entity in which you had an ownership interest, add to your own net tax the amount of tax paid by the pass-through entity. [7]
3. Apply the ratio of (i) your total long-term capital gain that is reported in both Washington and the other taxing jurisdiction because of the capital asset located in the other jurisdiction to (ii) your total gross income reported in the other taxing jurisdiction against your total tax liability in the other jurisdiction.

Gross income means your total income reported in the other jurisdiction, before application of any deductions, credits, or other subtractions.

4. Reduce the amount in Step 3 by the extent, if any, it exceeds your Washington capital gains excise tax liability. The remaining number is the amount of tax you paid to another taxing jurisdiction for purposes of the RCW 82.87.100(2) tax credit.

Example 1

Facts:

- In 2023, Jeff's total income is $100,000. This total consists of $90,000 in ordinary income and $10,000 in long-term capital gain.
- All of Jeff's 2023 income is taxable in State X. State X imposes an income tax with graduated tax rates.
- Jeff's total 2023 State X tax liability is $8,127.15, net of tax credits. Jeff is not an owner of a pass-through entity. Jeff pays the tax due to State X.
- The $10,000 long-term capital gain taxable in State X is also included in Jeff's Washington capital gains and subject to Washington capital gains excise tax. In addition, Jeff has other long-term capital gain not taxable in any state other than Washington. His total Washington capital gains amount is $300,000.

Result:

1. The net tax Jeff paid in State X was $8,127.15.
2. Jeff had no pass-through entity that paid any State X tax liability.
3. The ratio of (i) Jeff's long-term capital gain reported in both State X and Washington to (ii) total gross income reported in State X is $10,000 to $100,000, or 10%. Ten percent of the $8,127.15 in tax that Jeff paid to State X is $812.72.
4. Jeff's Washington capital gains excise tax liability on his $300,000 of Washington capital gains is $3,500.00.[8] Jeff is eligible to claim a $812.72 tax credit against his Washington capital gains excise tax for tax paid to another taxing jurisdiction.

Example 2

Facts:

- Jean is a Washington domiciliary and owns 50% of a partnership organized in State Y.

- In 2023, Jean earned a total of $700,000 in long-term capital gain, all of which was included in her Washington capital gains.
- Jean also earned income taxable in State Y. The 2023 State Y-taxable income consisted of $50,000 in ordinary income and $110,000 in long-term capital gain, all of which was her distributive share of income generated by her State Y partnership.
- In State Y, pass-through entities may elect to pay an entity-level tax. The owners of an electing pass-through entity are entitled to a credit equal to 100% of the owner's distributive share of the entity tax paid. In 2023, Jean's partnership elected to pay the State Y entity-level tax.
- The State Y tax on the partnership's 2023 income totaled $10,000. Jean's individual State Y tax liability was $0 after application of the pass-through entity tax credit.

Result:

1. The net tax Jean paid to State Y was $0.
2. Her pass-through entity paid $10,000, which relieved Jean's liability for State Y tax. Thus, the $10,000 is an amount of tax Jean is considered to have paid in State Y for purposes of the RCW 82.87.100 tax credit.
3. The ratio of Jean's total long-term capital gain reported in both Washington and State Y to total gross income reported in State Y was $110,000 to $160,000, or 68.75%. This ratio, applied against the total State Y tax liability, is $6,875.00.
4. Jean's Washington capital gains excise tax liability on her $700,000 of Washington capital gains is $31,500.00.[9] Jean is eligible to claim a $6,875.00 tax credit against her Washington capital gains excise tax for tax paid to another taxing jurisdiction.

This interim guidance statement will remain in effect until the Department issues final guidance or cancels the interim statement.

If you have any questions about this guidance, please contact Michael Hwang at MichaelHw@dor.wa.gov.

[1]RCW 82.87.040.

[2]RCW 82.87.020(1), (3), (13).

[3]"Taxing jurisdiction" means a state of the United States other than the state of Washington, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any foreign country or political subdivision of a foreign country. RCW 82.87.100(2)(b)

[4]This guidance assumes that the Washington tax is lawfully due.

[5]For this purpose, the Department presumes that intangible personal property is “within the other taxing jurisdiction” if the other taxing jurisdiction legally imposed tax on the long-term capital gain derived from the sale or exchange of the intangible personal property.

[6]Upon request, the Department may accept other methodologies that provide a more accurate representation of tax paid to another jurisdiction. Under any approach, the taxpayer has the burden of proving the amount of the credit claimed; you must preserve records that substantiate the credit amount. The Department may require your submission of additional documents at the Department's request. See WAC 458-20-300(6)(b).

[7]These payments by the pass-through entity may have been made on a composite return, through withholding, or as part of pass-through entity-level tax. In general, they must relieve you from liability for payment of tax on an individual basis.

[8]After application of the $250,000 standard deduction (($300,000 - $250,000) * 0.07 = $3,500).

[9]After application of the $250,000 standard deduction (($700,000 - $250,000) * 0.07 = $31,500).