

Interim statement regarding the capital gains excise tax and Section 1256 contracts

This interim guidance statement was cancelled on January 26, 2024. For section 1256 contracts, only gains and losses recognized from a taxpayer's sale or exchange of a section 1256 contract are included in the Washington capital gains excise tax base, and only if the contract was held for more than one year. In this situation, the taxpayer should report the long-term capital gain or loss they recognized for federal tax purposes from the sale or exchange, i.e., 60% of the total gain or loss."

October 11, 2023

Purpose

This interim guidance prescribes the methodology for determining the Washington capital gain from Title 26 U.S.C. Section 1256 contracts for purposes of the Washington capital gains excise tax.

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

RCW 82.87.040(1) imposes an excise tax on the sale or exchange of long-term capital assets equal to 7% of an individual's Washington capital gains. Under RCW 82.87.020(13), "Washington capital gains" means an individual's adjusted capital gain. RCW 82.87.020(1), in turn, defines "adjusted capital gain" as federal net long-term capital gain subject to specific adjustments. "Federal net long-term capital gain" generally means the net long-term capital gain reportable for federal income tax purposes.

For purposes of the Washington capital gains excise tax, gains and losses from Section 1256 contracts included in a taxpayer's federal net long-term capital gain should be included in the taxpayer's Washington capital gains.¹

For federal tax purposes, the aggregate capital gain or loss recognized from all Section 1256 contracts is treated as a combination of short-term and long-term capital gain or loss, regardless of how long the contracts were held. Additionally, each Section 1256 contract held by a taxpayer at the end of the tax year is treated as if it was sold for its fair market value, and any gain or loss is taken into account for that tax year. That is, the Section 1256 contracts are "marked-to-market" at the close of the taxable year. Any unrealized gains or losses from those marked-to-market adjustments are netted with realized gains and losses from sold or closed Section 1256 contracts. This aggregate profit or loss from all Section 1256 contracts is reported on federal Form 6781, and 60% of that net amount is treated as long-term capital gain or loss.

If the contract is held in more than one tax year, an adjustment is made to the gain or loss realized in the next year in order to prevent federal double taxation or double deduction. For example, if a taxpayer's beginning position in 2023 in a Section 1256 contract was \$100, and its value was \$200 on December 31, 2023, the taxpayer would be subject to tax on the difference between those values, \$100. In 2024, the taxpayer's beginning position would be \$200 for purposes of determining the 2024 gain or loss.

Calculating Washington Capital Gain from Section 1256 Contracts

For purposes of the Washington capital gains excise tax, Section 1256 contracts that are treated as sold at the close of the taxable year pursuant to Title 26 U.S.C. Section 1256(a) are considered sold for the purposes of the Washington capital gains excise tax. Thus, any long-term capital gain or loss from such sale, as determined by Title 26 U.S.C. Section 1256(a)(3), is included in the calculation of the individual's adjusted capital gain and Washington capital gains to the extent such gain or loss is included in calculating the individual's federal net long-term capital gain.²

Example 1

Facts:

- In 2024, Mavis, a Washington domiciliary, recognized both gains and losses from various Section 1256 contracts as listed in the chart below, resulting in a net gain of \$1,000. For federal tax purposes, 40%

of the net gain (\$400) is treated as short-term capital gain and 60% (\$600) is treated as long-term capital gain.

Section 1256 Contract	Time Held	Contract Status	Disposition	Gain/(Loss)
3-month Regulated Futures	3 months	Closed	Cash Settlement	\$1000
18-month Equity Option	1 year, 3 months	Closed	Contract Sold	\$300
3-month Nonequity Option	1 month>	Closed	Physical Delivery	(\$200)
24-month Nonequity Futures	1 year, 9 months	Open	N/A	(\$100)
Net Section 1256 Gain/(Loss) Reported on Form 6781				\$1000
Section 1256 Gain Treated as Federal Short-Term Capital Gain				\$400
Section 1256 Gain Treated as Federal Long-Term Capital Gain>				\$600

Conclusion:

- Mavis's federal net long-term capital gain from the Section 1256 contracts in 2024 is \$600. No specific adjustments in RCW 82.87.020(1) modify this total. Therefore, when calculating his 2024 Washington capital gains excise tax liability, Mavis should include the \$600 recognized as long-term capital gain in his Washington capital gains amount.

Example 2

Facts:

- In 2024, Mary, a Washington domiciliary, recognized only gains from various open Section 1256 contracts as listed in the chart below, resulting in a net gain of \$1,300. For federal tax purposes, 40% of the gain (\$520) is treated as short-term capital gain and 60% (\$780) is treated as long-term capital gain.

Section 1256 Contract	Time Held	Contract Status	Disposition	Gain/(Loss)
6 month Foreign Currency	3 months	Open	N/A	\$550
18-month Equity Option	1 year, 3 months	Open	N/A	\$250
24-month Nonequity Option	1 month	Open	N/A	\$250
24-month Nonequity Futures	1 year, 9 months	Open	N/A	\$250
Net Section 1256 Gain/(Loss) Reported on Form 6781				\$1,300
Section 1256 Gain Treated as Federal Short-Term Capital Gain				\$520
Section 1256 Gain Treated as Federal Long-Term Capital Gain				\$780

Conclusion:

- Mary's federal net long-term capital gain from the Section 1256 contracts in 2024 is \$780. No specific adjustments in RCW 82.87.020(1) modify this total. Therefore, Mary should include the \$780 recognized as long-term capital gain in her Washington capital gains amount.

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 Ryan Becklean at RyanBe@dor.wa.gov.

¹A “Section 1256 contract” means any regulated futures contract, any foreign currency contract, any nonequity option, any dealer equity option, and any dealer securities futures contract. Title 26 U.S.C. § 1256(b).

²This assumes that the gain or loss is allocated to Washington because the taxpayer is domiciled in Washington. See RCW 82.87.100(1)(b).



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