

The Stay and Pay Penalty

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Why the new proposed “Millionaires Tax” has Washington State business owners contemplating leaving the state.



In recent years, our discussions with business owners, professional advisors, and referral partners across Washington State have increasingly focused on the potential tax implications associated with business ownership, residency, and liquidity events. In particular, the implementation of Washington's capital gains tax in 2022 and the Legislature's current consideration of an additional high-income “Millionaires Tax” have led many business owners to evaluate how these developments may affect long-term planning decisions. These discussions are often intense, and we have found that a lack of a numerical example hinders the discussion of the potential effects.

To fill that need, this article is intended to provide an informational overview of current and proposed tax considerations and outline potential planning implications for business owners and their advisors. It is not intended to advocate for or against any tax policy, but rather to illustrate a concrete example of how these policies affect an individual's after-tax proceeds. But before we get to the numbers, a quick background on the policies themselves.

Washington State Capital Gains Tax and Proposed High-Income Tax

Washington State implemented a capital gains tax effective in 2022, imposing a long-term capital gains of 7.0% of gains above \$278,000 plus an additional 2.9% (9.9%) on gains above \$1,278,000. Since its enactment, some business owners have explored the impact of this tax on anticipated liquidity events, including the sale of closely held businesses. Anecdotally, we noticed that after the passing of this capital gains tax, the number of business owners considering obtaining residency outside of Washington State to not be subject to the capital gains tax when they sell their business increased substantially. However, accomplishing that is easier said than done, as Washington has fairly strict guidelines in order to establish residency outside of the state.

Now, Washington State legislators are currently reviewing a proposal commonly referred to as the “Millionaires Tax.” Based on publicly available information, the proposal would impose an additional tax of approximately 9.9% on annual income above \$1 million. The tax base under consideration may include wages, business income, and capital gains.

If enacted as currently proposed (still subject to final legislative approval), the high-income tax would apply in addition to the existing Washington capital gains tax. Under this structure, a Washington resident selling a business could be subject to a combined state-level tax rate of approximately 18-20% on applicable income above \$1 million. When combined with current federal long-term capital gains tax rates and the net investment income tax, total marginal taxation on qualifying income could exceed 40%, depending on an individual's specific tax profile.

Current indications suggest that the proposed tax would not take effect until the 2029 tax year; however, the proposal remains subject to legislative review and potential modification.

Illustrative Case Study

The following simplified case study is provided for illustrative purposes only. Actual outcomes will vary based on entity structure, income composition, deductions, exemptions, and changes in tax law.

Background:

Stacy Smith is a 60-year-old business owner who founded and has operated a manufacturing company in Washington State for approximately 30 years. The company generates approximately \$80 million in annual revenue and \$10 million in EBITDA. Stacy is an absentee owner who does not draw a salary/distribution. The business has no debt, and Stacy estimates a potential sale price of \$50 million.

Stacy is evaluating retirement and a potential sale of the business within the next five years. Three scenarios are outlined below.

Scenario 1: Sale Prior to Implementation of the “Millionaires Tax”

Stacy remains a Washington resident and elects to sell the business in 2027, prior to the potential implementation of the proposed high-income tax.

Under this scenario, Stacy would generate approximately \$50 million in total income, incur approximately \$16.8 million in combined federal and state taxes, and retain net proceeds of approximately \$33.2 million.

Scenario #1							
Year	Income	Federal tax		State tax		Total Taxes*	Total proceeds
		Income tax	Capital Gains tax	Millionaires Tax	Capital Gains Tax		
2027 sale proceeds	50,000,000	-	(11,900,000)	-	(4,893,478)	(16,793,478)	33,206,522

*all numbers are approximate figures and rounded for presentation purposes. Speak with your CPA for your specific situation

Scenario 2: Sale After Implementation of the “Millionaires Tax”

Stacy remains a Washington resident and continues operating the business through 2029, selling the business after the proposed high-income “Millionaires tax” is assumed to be in effect.

Under this scenario, Stacy would generate approximately \$50 million in total income, incur approximately \$21.6 million in combined federal and state taxes, and retain net proceeds of approximately \$28.3 million.

Scenario #2							
Year	Income	Federal tax		State tax		Total Taxes*	Total proceeds
		Income tax	Capital Gains tax	Millionaires Tax	Capital Gains Tax		
2029 sale proceeds	50,000,000	-	(11,900,000)	(4,851,000)	(4,893,478)	(21,644,478)	28,355,522

*all numbers are approximate figures and rounded for presentation purposes. Speak with your CPA for your specific situation

Scenario 3: Change in Residency Prior to Sale

Stacy relocates to Florida in 2026 and she sells the business in 2027 after establishing residency outside Washington State, thus not paying capital gains in the State of Washington and not paying the Millionaires tax.

Under this scenario, Stacy would generate approximately \$50 million in total income, incur approximately \$11.9 million in combined federal and state taxes, and retain net proceeds of approximately \$38.1 million.

Scenario #3								
Year	Income	Federal tax			State tax		Total Taxes*	Total proceeds
		Income tax	Capital Gains tax	Millionaires Tax	Capital Gains Tax			
2027 sale proceeds	50,000,000	-	(11,900,000)	-	-	(11,900,000)	38,100,000	

*all numbers are approximate figures and rounded for presentation purposes. Speak with your CPA for your specific situation

Summary Considerations

These scenarios demonstrate how the timing of a business sale, residency status, and potential tax law changes may materially affect after-tax outcomes for business owners. We recognize that this example is oversimplified, and in reality, differences in transaction structure, the owner’s tax basis in the business, their other income, and other variables can result in marginal differences to this illustration. Nevertheless, the case study above shows the combination of the already imposed Capital Gains Tax and the proposed Millionaires Tax increase the tax hit by approximately 81% and in this case is potentially \$9.7 million of additional tax. Said differently, the choice to remain a Washington State resident could nearly double Stacy’s tax bill and cost her nearly a fifth of the value of her business. This math clearly illustrates the underlying pull for why we’re hearing about more Washington State business owners considering relocation.

Of course, there are more factors at play in the sale of a business than taxes, but this illustration goes to show how business owners should ensure they are aware of how a transaction and timing of a transaction would alter their after-tax proceeds. We encourage business owners to work closely with their tax, legal, and financial advisors to evaluate how current and proposed tax laws may apply to their specific circumstances and to develop strategies aligned with their long-term objectives.

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