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Financial Services State and Local Tax Newsletter

Tracking the significant changes in state taxes for financial services

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In this issue

Welcome to the Q1 2026 edition of our Financial Services SALT newsletter. There's no shortage of activity at the state level right now, and Washington is taking center stage for this newsletter. This quarter, we take a closer look at the B&O rate increases, new surcharges, and the repeal of some long-held preferences, all with an eye toward what they actually mean for financial services companies. And, on the individual side, there’s a new millionaires’ income tax and capital gains surcharge that should be considered.

Beyond Washington, we cover the federal court ruling striking down Illinois' interchange fee ban, how the One Big Beautiful Bill Act could reshape state income tax compliance, pass-through entity tax updates from several states, and a change to USPS postmark rules that you should keep on your radar.

There's plenty to examine, so we hope you find this edition valuable. As always, don't hesitate to reach out to discuss how these developments apply to your organization.

Best regards,

Caragh DeLuca

Sleepless in Olympia - Washington state’s tax landscape continues to change

As many state tax professionals are aware, Washington State historically has not imposed a tax on either personal or corporate net income. Rather, the state has generated revenue through a combination of property taxes, sales taxes, and taxes based on gross receipts (commonly known as “Business & Occupation” or “B&O” tax). While this approach to taxation is clearly different (and arguably more regressive) than that utilized in most states, it is not completely by choice. Specifically, the Washington legislature has been limited by language in the state constitution that was interpreted by the Washington Supreme Court almost a century ago to prevent the imposition of a graduated income tax. Consequently, the legislature has been forced to increase rates or expand the base on existing taxes, as well as find creative ways to raise revenue, while regularly managing budget shortfalls.

Washington has implemented several recent legislative changes that taxpayers should understand as they assess current obligations and prepare for what may come next.

Taxation of individuals

Old controversy resurrected by new "millionaire's tax"

In 1933, the Washington State Supreme Court held in *Culliton v. Chase* that a graduated income tax passed by the voters violated the state constitution because "all taxes shall be uniform upon the same class of property" and "income" should be considered property for these purposes. Interestingly, on the same day, the court decided *Stiner vs. Yelle,* where it upheld the first Washington B&O tax, which was assessed on "the privilege of engaging in business activities" as measured by "gross proceeds of sales, or gross income, as the case may be." In reaching its decision, the court distinguished between an impermissible property tax on income and a constitutional excise tax imposed on a particular activity or privilege that is *measured* by income. Several years later, the court also applied this reasoning when upholding the constitutionality of the state's retail sales tax.

After these decisions, there were several other attempts over the years to enact both graduated personal and corporate income taxes. However, the courts consistently struck these down as unconstitutional. In 2021, the Washington legislature enacted a tax on an individual's sale or exchange of certain long-term capital assets on or after January 1, 2022. The legal question was whether that tax was an impermissible income tax or — similar to the Washington B&O tax — a permissible excise tax imposed on a specific activity. In 2023, the Washington Supreme Court in *Quinn v. State of Washington* concluded that the capital gains tax was a permissible excise tax. In reaching its conclusion, the court stated:

> Plaintiffs confuse the tax's subject matter with its measure. The tax is not levied on capital gains; rather, it is measured by capital gains. Our cases unequivocally hold that excise taxes levied on a particular privilege or incident of property ownership may be measured by income, and this does not transform the fundamental nature of the tax.

Following this decision, the legislature began exploring whether there was a legal path towards enacting an income tax. On March 30, 2026, Governor Bob Ferguson (D) signed Engrossed Substitute Senate Bill 6346 into law, which imposes a 9.90% income tax on individuals with adjusted gross income exceeding $1 million, applicable to income earned beginning in 2028. This delayed effective date was put in place in anticipation of legal challenges, and (as expected) a lawsuit already has been filed challenging the tax on state constitutional grounds.

In addition to the substantive argument, there was also controversy over whether the voters were prevented from overturning the tax through a referendum. Specifically, the legislation included a "necessity clause" (i.e., a provision that the tax is "necessary for the support of the state government and its existing public institutions"), which could have been included to prevent opponents from attempting to use the

referendum process as a manner to repeal the tax. The Washington Supreme Court granted an emergency motion for accelerated review of this procedural issue and upheld the necessity clause as valid. Thus, groups planning to challenge the tax will be required to go through a more difficult process.

Developments on both the substantive and procedural issues related to this legislation are expected to continue throughout 2026 and beyond.

Capital gains tax

As stated above, the Washington capital gains tax is imposed on an individual's sale or exchange of certain long-term capital assets on or after January 1, 2022. As originally enacted, the tax rate was 7% on taxable gains greater than the allowed standard deduction ($278,000 in 2025). However, legislation enacted last year provided for an additional 2.9% tax on long-term capital gains that exceed $1 million on or after January 1, 2025. Consequently, the new capital gains rate structure imposes a 7% tax on net long-term capital gains up to $1 million (less the allowed standard deduction), and 9.9% for net long-term capital gains exceeding $1 million.

Estate tax

Washington's estate tax has also undergone recent changes. Historically, the state imposed a top estate tax rate of 20% on taxable estates exceeding $9 million. As part of recent legislation enacted in 2025, the state increased estate tax rates, with the top rate rising to 35%, making Washington's estate tax among the highest in the country. However, in 2026, the legislature reversed course and enacted legislation reducing the top rate back to 20%, effective for decedents dying on or after July 1, 2026. The change reflects concerns that the higher rates could encourage taxpayers to relocate outside the state.

Business & Occupation (B&O) taxes

Refresher of 2025 state B&O rates increases

The Washington B&O tax is a gross receipts tax measured on the value of products, gross proceeds of a sale, or gross income of a business. The B&O tax rate that applies depends on the business classification of the activity. Most asset managers, including investment advisers, portfolio managers, and similar firms, are taxed under the general "service & other activities" classification. Effective October 1, 2025, the B&O tax rate for these kinds of businesses with gross income over $5 million increased from 1.75% to 2.1%. Specifically, effective October 1, 2025, the following rate structure applies to these businesses:

- Less than $1 million: 1.5%

- $1 million to less than $5 million: 1.75%
- $5 million or more: 2.1%.

It should be noted that businesses that are affiliated with other "persons" determine whether they exceed the $5 million dollar threshold on an aggregate basis. Thus, individual companies that have gross income below the $5 million threshold will be required to use the 2.1% rate if aggregate gross income for all affiliated persons is equal to or greater than this amount. For these purposes, the term “affiliate” means “a person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another person.” The term “control” means “the possession, directly or indirectly, of more than eighty percent of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.”

In addition to this tax increase, the following surcharges should be considered:

- A new **Surcharge on High Grossing Businesses** imposes a temporary 0.5% surcharge on Washington taxable receipts in excess of $250 million. This surcharge is in addition to the B&O tax imposed on these businesses. Exemptions from the surcharge are available for certain types of income, including from manufacturing, select advanced computing businesses subject to the Workforce Education Investment Surcharge, and the Specified Financial Institution Surcharge. The surcharge went into effect on January 1, 2026, and will sunset at the end of 2029.
- Effective October 1, 2025, the **Specified Financial Institution Surcharge** increased from 1.2% to 1.5%. For these purposes, a “specified financial institution” is a financial institution that belongs to a consolidated group reporting at least $1 billion in annual net income on its consolidated financial statement for the prior calendar year (including adjustments for net income from noncontrolling interests).
- The **Workforce Education Investment Surcharge** (commonly referred to as the “advanced computing surcharge”) is imposed on “select advanced computing businesses” and is imposed in addition to the B&O tax. Prior to 2026, the surcharge was imposed at 1.22% of gross income and had an annual cap of $9 million; however, effective January 1, 2026, the surcharge significantly increased to 7.5% of gross income with an annual cap of $75 million.

  The surcharge applies to affiliated groups with more than $25 billion in worldwide gross revenue. If this threshold is met and at least one member of the group engages in “advanced computing” activities, the surcharge applies to the entire affiliated group. An affiliated group generally includes entities under common control, typically defined as more than 50% direct or indirect

ownership. Notably, “control” for surcharge purposes (50%) is a lower threshold than the threshold for B&O rate purposes (80%).

The activities that constitute “advanced computing” for Washington B&O are very broad, including designing or developing computer software or hardware, whether directly or contracting with another person, including modifications to computer software or computer hardware, cloud computing services, or operating as a marketplace facilitator, an online search engine, or online social networking platform. As a result, the surcharge could be applied to certain industries, including potentially to segments of financial services that may not have been the primary focus when the surcharge was enacted.

Investment income and the *Antio* decision

The Washington Supreme Court in *Antio LLC v. Department of Revenue* surprised many in 2024 when it upheld a lower court decision that investment income was only deductible for Washington B&O tax purposes when it was "incidental to the main purpose of a business." Previously, the fund industry relied on 2002 legislation that was interpreted as effectively providing a full investment income deduction to many types of fund structures. The court disagreed and limited the deduction to "incidental" investment activity (a standard that most funds would have difficulty meeting). In response to industry concerns, the Washington legislature in May 2025 provided a "fix" to this issue, but did not legislatively overturn *Antio.*

First, the legislature codified the *Antio* "incidental" test, thereby statutorily limiting when investment income is deductible for B&O tax purposes. The new law provided exceptions (and, thus, full deductions) for certain types of investment entities, including for those entities meeting the definition of a "collective investment vehicle" (generally, an entity holding passive investment assets for the benefit of investors and that generates at least 90% of its total gross income from "investments"). The legislation provided that a collective investment vehicle can take the form of a mutual fund, collective fund, and any similar investment vehicle, whether structured as a corporation, partnership, etc. While the legislation also has a broad definition of investments, it is unclear whether the investments typically held by other types of fund structures can qualify.

If certain funds do not qualify and their investment income (including gains) is not deductible for B&O tax purposes, the legislation provides that this income should be subject to the "service and other activities" classification and should be apportioned in accordance with Washington's "market based" sourcing regime. There is limited guidance on how to apply these rules to investment income, although additional administrative guidance is expected.

The legislation authorized the Washington Department of Revenue to provide an Investment Income Voluntary Disclosure Program, which offers a penalty- and interest-free path to compliance for entities with unreported investment income. This program is rolled out over two phases, the first from July 1, 2025, through April 30, 2026, and the second from July 1, 2026, through April 30, 2027.

Local B&O taxes (Seattle)

Seattle imposes its own B&O tax, generally applicable to businesses with a physical presence in the city. Effective January 1, 2026, the threshold increased from $100,000 to $2 million and now operates as a taxability threshold with the adoption of a standard deduction of $2 million. Businesses are still required to file returns even if their taxable gross revenue is below the $2 million threshold. In addition, Seattle B&O tax rates increased through 2032, with reduced rates beginning in 2033.

To learn more about these changes, please see our previously published Insights

Washington enacts a new tax on millionaires and estate tax changes

Washington State enacts significant tax legislation, May 29, 2025

Seattle adopts tax on certain compensation exceeding $1 million, April 7, 2025

Washington Supreme Court denied investment funds deduction for “amounts derived from investments,” December 2024

Banking highlight - Federal court upholds Illinois interchange fee ban on state and local tax and gratuities, enjoins data use restrictions

Illinois enacted legislation to prohibit interchange fees specifically on the state and local taxes and gratuity portions of electronic payment transactions. Illinois is the first state to enact such a provision.

The legislation was challenged and on February 10, 2026, the US District Court for the Northern District of Illinois issued a memorandum opinion and order in *Illinois Bankers Association et al. v. Raoul*, No. 24-7307, partially granting cross-motions for summary judgment in litigation challenging the Illinois Interchange Fee Prohibition Act (IFPA). The court upheld the IFPA provision prohibiting the charging of interchange fees on state and local tax and gratuity components of electronic transactions, finding it is not preempted under the National Bank Act or related federal statutes. However, the court permanently enjoined enforcement of the statute's data usage limitation as applied to national banks, federal savings associations, federal credit

unions, certain out-of-state state banks, and certain payment card networks and processors. The American Bankers Association indicated it intends to appeal the ruling, and the IFPA's interchange fee prohibition remains scheduled to take effect on July 1, 2026.

This decision elevates the importance of merchants identifying and transmitting tax components within electronic payment data, and the statute includes a $1,000 per-transaction civil penalty for certain violations by an entity that has received the required information.

Industry stakeholders have also raised concerns about the ability to comply with the IFPA given the substantial changes required to the existing data infrastructure used by merchants, issuers, and payment card networks. For merchants with large state and local tax remittances, the interchange fee provision may offset incremental costs resulting from the $1,000 cap instituted on the Illinois retailers' discount effective as of January 1, 2025.

Merchants and other electronic payment ecosystem participants with Illinois activity should assess readiness for the July 1, 2026 effective date while monitoring potential appellate developments.

Key considerations include:

- Evaluating whether point-of-sale systems can isolate state and local tax and gratuity components at the transaction level consistent with Illinois requirements
- Assessing ERP and tax engine configurations to transmit tax component data through the payment ecosystem
- Reviewing reconciliation procedures to confirm tax amounts remain identifiable and supportable for audit and reporting purposes
- Analyzing contractual arrangements with processors and acquirers regarding data transmission obligations.

Entities also should prepare contingency planning scenarios in light of further judicial developments and monitor potential legislative activity in other states that could expand similar limitations. Read more about this development here.

Redefining the starting line

While the federal tax law changes enacted by the One Big Beautiful Bill Act (OBBBA) are substantial (e.g., changes to interest deduction limits, modifications to research and experimental expense rules, and

enhanced depreciation deductions), they also create additional complexities for state income tax compliance. Over the coming months, this publication will aim to “Redefine the Starting Line” by helping taxpayers understand how OBBBA affects state income tax compliance by sharing timely guidance on trends and key issues through the 2025 extension and filing seasons and into the 2026 tax year. Leveraging our experience, we’re here to redefine *your* starting line as you navigate state income tax compliance under OBBBA.

Read our first issue here.

Pass-through entity tax updates

Pass-through entity (PTE) taxes remain a significant area of focus for taxpayers, policymakers, and state tax authorities as states continue to refine their approaches and consider new legislation. Below is a summary of some of the key recent enactments and notable proposals across the states.

ENACTMENTS

Maine – On April 10, L.D. 2212 was signed into law enacting an elective PTE tax effective for years beginning on or after January 1, 2026. Eligible partnerships and S corporations can make an annual, irrevocable election to pay income tax at the entity level, calculated by applying the state's highest marginal individual income tax rate to the entity's aggregate taxable income of its qualified members (individuals, trusts, and estates). The statute also requires electing entities to pay an additional 10% estimated tax on behalf of nonresident qualified members, provides a filing exception for nonresidents whose entire Maine income flows through electing entities, and mandates quarterly estimated tax installments with automatic underpayment penalties. Qualified members receive a credit for 90% of the PTET amount reported to them, and the entity must report each member's share of income and tax within 30 days of the return due date.

Maryland - Senate Bill 284, the "Budget Reconciliation and Financing Act of 2026," enacted changes by altering how an electing PTE calculates its tax base for resident members. The primary amendment establishes a new default method requiring the tax for resident members to be calculated based on their entire distributive or pro rata share of the PTE's income.

In addition to the new default rule, the bill provides an alternative. An electing PTE now can make an annual election to calculate the tax for its resident members based only on the income derived from or reasonably attributable to the PTE's trade or business within Maryland, which is similar to the prior method. The PTE must indicate its choice on its tax return; if no election is made, the tax will be calculated using the default method based on the full distributive share of resident members' income.

These new rules altering the calculation of Maryland's income tax for electing PTEs are applicable to tax years beginning after December 31, 2026. This means the changes, including the new default and elective methods for calculating the tax base for resident members, will first apply to the 2027 tax year. While the Budget Reconciliation and Financing Act of 2026 generally takes effect on June 1, 2026, the bill achieves this delayed applicability for the PTE tax changes by amending a prior law, Chapter 604 of the Acts of the General Assembly of 2025, and changing its effective date.

Oregon - On March 31, S.B. 1510 was enacted making the following changes to the Business Alternative Income Tax (BAIT): (1) extends the BAIT by two years through 2027, (2) adds a new rule allowing overpayments to be credited against subsequent estimated tax, and (3) ties the availability of the BAIT election to the continued existence of the federal SALT deduction limitation.

Utah – H.B. 77, enacted on March 23, eliminates the December 31, 2025 expiration date making the PTE tax permanent.

Virginia – Enacted on February 20, HB 29 amends and re-enacts the 2025 budget bill and eliminates the December 31, 2026 sunset date for the elective income tax on PTEs.

Washington - As part of the new millionaire's tax, SB 6346 enacts a new PTE tax regime, which takes effect for tax years beginning January 1, 2028 and the first returns and payments are due in 2029. Partnerships, limited liability companies, and S corporations, can elect to pay the tax at the entity level at the same 9.90% rate on the income of participating owners. This election is made annually, is irrevocable for the tax year, and must be filed no later than June 15th of the tax year. Individual owners can choose not to participate in the election. Guaranteed payments, separately stated items, and investment income are included in taxable income to the same extent these items would be included in a participating owner's individual Washington base income. Participating owners receive a credit against their individual tax liability for their share of the entity-level tax.

PROPOSED

A couple of key proposals include

Massachusetts – H.5280 would create a separate PTET election on income exceeding the surtax threshold. The legislation would create new "Chapter 63E," which essentially mirrors the original PTET except that under this "second" PTET:

- the tax rate is 4%;

- the definition of a "qualified member" does not include a shareholder, partner, or member whose allocable share of income included in their Massachusetts taxable income does not exceed the surtax threshold; and
- the definition of "qualified income taxable in Massachusetts" is limited to the sum of the amounts by which the amount allocated to each qualified member exceeds the surtax threshold.

The credit is still 90% of each qualified member's share of this "second" PTET paid by the pass-through entity.

Minnesota - S.F. 3405/H 3127 would temporarily restore the expired elective PTE tax until December 31, 2029. While the bill was introduced in 2025, it is still pending in the legislature.

New York - The New York budget has not yet been signed, but there are key differences regarding the PTET across the Governor's Executive Budget and the Senate and Assembly bills. The Governor's Executive Budget (Part H) proposes to extend the annual PTET election deadline from March 15 to September 15 for both the New York State (NYS) and New York City (NYC) PTET regimes, a change which the Senate's bill (Part H) accepts. The Assembly's bill, however, omits this extension, retaining the original March 15 deadline. The value of the PTET credits also differ. The Senate bill (Part GG) proposes to reduce the NYS PTET credit to 90% and the NYC PTET credit to 75% (Part RR). The Assembly bill aligns with the Senate on the city credit (Part OO), also proposing a reduction to 75%, but it does not propose any change to the state credit. The Governor's budget, in contrast, proposes no changes to either the NYS or NYC PTET credits, leaving them at 100%. The Governor recently equated the proposed PTET credit reductions to income tax increases, which she has opposed since coming into office in 2021, and challenged the New York City mayor to "look at your expenses," rather than increase taxes.

Other state developments of interest

New US Postal Service rules could have implications for tax filers

Effective December 24, 2025, the US Postal Service (Postal Service, or USPS) adopted new rules regarding postmarks, explaining that postmarks may be applied at a regional processing center, rather than at the local post office where mail is dropped off. As a result, the postmark date on a mailed item may be later than the date it was presented to the Postal Service. While the Postal Service notes that this is not a change in USPS practice, it has made adjustments to USPS transportation operations that will result in some mail pieces not arriving at originating processing facilities on the same day that they are mailed.

For federal, state, and local tax filings or payments where timeliness is determined by the postmark date, the potential lack of alignment between the date the USPS accepts possession of a mailed item and the postmark date represents a risk that an item dropped off on or near a due date could receive a postmark dated after the deadline.

Taxpayers should consider using electronic filing or payment options when available or mailing time-sensitive filings and payments earlier and maintaining proof of mailing. As explained in the updated rules, taxpayers also can request a manual postmark at the local post office at the time of mailing or use a Certificate of Mailing in conjunction with US certified mail, where appropriate. Importantly, the rules caution that postage meter dates, kiosk labels, or other pre-printed postage not affixed by the Postal Service do not serve as proof of timely mailing.

California's proposed Billionaire Tax Act ballot initiative

The 2026 Billionaire Tax Act, Initiative No. 25-0024, is a proposed statewide ballot initiative for the November 2026 California ballot that would impose a one-time 5% excise tax on individuals with net worth exceeding $1 billion. The tax would introduce new and complex valuation methods for net worth and business interests, including a book value plus earnings multiplier calculation, as well as strict rules regarding charitable pledges and trusts. The initiative also signals increasing political focus around taxing wealth in California, which has implications for taxpayers in the state's top wealth tiers.

If passed, this tax potentially could raise approximately $100 billion in one-time revenue allocated primarily to healthcare funding and food assistance programs through the newly created 2026 Billionaire Tax Reserve Fund. Notably, the proposal has generated early opposition from Governor Gavin Newsom (D) and the California Chamber of Commerce, forecasting a potentially contentious campaign ahead. Read more about this proposal here.

Texas Comptroller adopts amended margin tax rule on determining total revenue

The Texas Comptroller of Public Accounts on February 20 adopted final rule amendments impacting the calculation of total revenue subject to the franchise (margin) tax. The amended rule reflects statutory changes, judicial decisions, and the Comptroller's policy positions potentially impacting a broad range of businesses. In particular, the amended rule formally adopts the Comptroller's interpretation regarding the state's application of the Internal Revenue Code (IRC) announced in December (see PwC's Insight for details here).

Taxpayers should re-evaluate their Texas franchise tax calculations for the 2026 franchise tax report, which is based on the accounting period ending date in 2025. Taxpayers particularly should focus on items of total revenue and related subtractions or deductions that previously were not considered due to the general understanding that Texas conformed to the 2007 IRC for all components of the franchise tax. Further, because it is the Comptroller's statutory interpretation, and the statute has not been amended in this respect, there could be refund opportunities based on applying the IRC then in effect for open years. Read more about these changes here.

Let's talk

For a deeper discussion of how these developments might affect your business, please contact your Financial Services State and Local Tax team member.

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