

Excise Tax Advisory

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Graduated Real Estate Excise Tax (REET): Land Classifications & Predominant Use

Purpose

Effective January 1, 2020, pursuant to ESSB 5998, Chapter 242, Laws of 2019, sales of real property are subject to graduated REET rates, with the exception of sales of real property classified as either “agricultural land” or “timberland,” which remain subject to a REET rate of 1.28 percent.

This Excise Tax Advisory (ETA) explains the process of identifying the proper land classification of real property for purposes of the real estate excise tax. It also explains the process of determining the predominant use of land, in cases where a sale of real property includes land classified as either “agricultural land” or “timberland” and non-classified land.

Definitions

“**Agricultural land**” means “farm and agricultural land” and “farm and agricultural conservation land, as those terms are defined in RCW 84.34.020, including any structures on such land. For example, the term includes land generally falling within the following descriptions:¹

- A parcel of land that is five acres or more but less than twenty acres, that produces an annual gross income from agricultural uses of \$200 or more per acre in three out of five years.
- A parcel of land less than five acres in size that produces an annual gross income from agricultural uses of at least \$1,500 dollars in three out of five years.
- Certain land on which employee or farm owner housing is located.

¹ See WAC 458-30-200 for the full requirements for farm and agricultural land.

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- Land on which appurtenances necessary for agricultural production is located.
- Land used primarily for certain equestrian-related activities.
- Land used primarily for horticultural purposes.

“Classified land” refers to land defined as “agricultural land”, “agricultural conservation land”, or “timberland”, as those terms are defined in chapters 84.34 and 84.33 RCW, respectively.

“Non-classified land” refers to land that is not defined as “agricultural land”, “agricultural conservation land”, or “timberland”, as those terms are defined in chapters 84.34 and 84.33 RCW, respectively.

“Timberland” is land classified under chapter 84.34 RCW or designated under chapter 84.33 RCW, including structures and timber on timberland, as well as timber sold apart from the timberland. The term includes “forestland”, as that term is defined in RCW 84.33.035. The term generally means any parcel of land that is five or more acres, or multiple parcels of land that are contiguous and total five or more acres, and devoted primarily to the growth and harvest of timber for commercial purposes. The term includes land used for incidental uses that are compatible with growing and harvesting timber, but no more than ten percent of the land may be used for such incidental uses. Timberland includes the land on which appurtenances necessary for the production, preparation, or sale of the timber products exist in conjunction with land producing these products. The term, however, does not include a residential homesite.²

Determining Proper Land Classification

RCW 82.45.060(3)(a) requires sales of real property with multiple uses to be classified according to the property’s predominant use for REET purposes, i.e., classified land or non-classified land.

For property tax purposes under Title 84 RCW, land having multiple uses is treated as agricultural land or timberland according to the land’s “primary use.” The same analysis applies in determining land classifications for REET purposes. WAC 458-30-200(2)(II) defines “primary use” as follows:

“Primary use” means the existing use of a parcel or parcels of land so prevalent that when the characteristic use of the land is evaluated a conflicting or nonrelated use appears to be very limited or excluded. The primary use of a parcel does not represent a specific percentage of the total classified land.

² See RCW 84.34.020(3) for the statutory definition of the term “timberland.”

Accordingly, if real property qualifies as agricultural land or timberland land for property tax purposes, it will be considered classified land for REET purposes.

Note: Sales of standing timber that are exempt from REET under RCW 82.45.195 are excluded for purposes of determining: 1) the land's proper classification and 2) the predominant use of land included in a sale of real property.

Determining Predominant Use

A sale of real property includes any conveyance, grant, assignment, quitclaim, or transfer of ownership or title of real property (or interest therein) for a valuable consideration. A sale of real property also includes the transfer or acquisition within any thirty-six month period of a controlling interest in any entity with an interest in real property located in this state for a valuable consideration.

One or more separate parcels of real property may be included in a single real property sale.³ If a sale includes both classified and non-classified land, the predominant use of the real property must be determined in order to establish the REET arising from the sale. Predominant use is determined by two equal factors: 1) the square footage of the real property and 2) the county-assessed value of the real property. Property is predominantly used as classified land if, on average, the classified portion of the property accounts for at least 50% of its area and value. This determination is made as follows:

1. Divide the area of classified land by the area of all land included in the sale.
2. Identify the county-assessed value⁴ of classified land included in the sale.
 - a. **Note:** The Department will not consider values other than the county-assessed valuation of real property for purposes of the predominant use determination.
3. Divide the county-assessed value of classified land by the county-assessed value of all land include in the sale.
4. Add the quotient in step 1 to the quotient in step 3, then divide the sum by two.
 - a. If the result is equal to or greater than 0.5, all of the land included in the sale is predominantly "agricultural land" or "timberland" and is subject to REET at the flat 1.28% rate.
 - b. If the result is less than 0.5, all of the land included in the sale is predominantly "non-classified land" and is subject to the graduated REET rates.

³ See RCW 82.45.010(1) for the statutory definition of the term "sale" and RCW 82.45.032(1) for the statutory definition of the terms "real estate" or "real property."

⁴ Current Use valuation.

Example A:

A real property sale includes 2 parcels of land (parcel A and parcel B). The selling price is \$1,000,000. Parcel A is classified land (agricultural land) and Parcel B is non-classified land. Parcel A is 1,800,000 square feet. Parcel B is 200,000 square feet. The county assessed value of Parcel A is \$75,000. The county assessed value of Parcel B is \$550,000. The real property's predominant use is determined as follows:

1. **Square footage of classified land to total land:** 0.90 (1,800,000 sq. ft. / 2,000,000 sq. ft.)
2. **County assessed value of classified land:** \$75,000
3. **County assessed value of classified land to total land:** 0.12 (\$75,000 / \$625,000)
4. **Predominant use determination:** 0.51 $((0.90 + 0.12)/2)$

Outcome: The predominant use of the land included in the sale is for a classified purpose. As a result, the \$1,000,000 sale is subject to REET at the flat 1.28% rate. The REET liability is \$12,800.

**Real Estate Excise
Tax Avoidance**

ESSB 5998 authorizes the Department to disregard the form of a transaction or series of transactions and determine the proper tax treatment based on the substance of a transaction or series of transactions. This authority includes, but is not limited to, treating multiple sales as a single sale as necessary to prevent the parties to a sale from reducing the tax liability, when it appears the transaction(s) was arranged with an intent to achieve a reduced effective tax rate.

In cases where the Department determines the actual substance of a transaction differs from how the seller reports the transaction(s), the Department will disregard the form of the transaction(s) and determine REET according to its actual substance.

Example B:

Assume the facts from Example A, except that Parcel A is non-classified land and Parcel B is classified land. After determining the predominant use of the land included in the sale is for a non-classified purpose and subject to the graduated REET rates, the seller and buyer agree to complete a separate sales transaction for each parcel, for purposes of reducing the REET liability.

Outcome: If the Department determines the seller completed to separate sales transactions for the purpose of avoiding REET, the Department will disregard the form of the reported sales, and treat the sales as a single transaction.

IMPORTANT: The Department is currently in the process of developing published guidance regarding REET avoidance schemes. The example above is intended to make buyers and sellers of real property generally aware of the Department’s authority to disregard the form of real property transactions.

Taxpayers unsure of their reporting requirements may disclose the pertinent details of a transaction and request a binding letter ruling from the Department.

**Land Classification
Based on Continued
Land Use**

For REET purposes, real property is only considered classified land if the buyer indicates it will continue to use the land in a qualifying manner and the county assessor approves the land for such continued use.

For property tax purposes, sales of real property that include classified land require determinations of whether the buyer intends to continue using the property in a manner required for classification of the property as classified land. Buyers reflect their land use intentions for this purpose on a *Notice of Continuance*. County assessors determine whether the land will continue to be primarily used as classified land.

Thus, in cases where a County Assessor indicates the buyer’s intended use of classified land reflects continued use of the land as agricultural land or timberland, the seller will classify the real property as agricultural land or timberland for purposes of determining the predominant use of real property included in the sale.⁵

In cases where the County Assessor indicates the buyer’s intended use would remove the property from the agricultural land or timberland classification, the real property is non-classified land for purposes of determining its predominant use for REET purposes.

⁵ Prior to filing the REET affidavit with the County Treasurer, the buyer must complete a “notice of continuance” (for sales of agricultural land) or “timber management plan” (for sales of timberland) with the County Assessor. The County Assessor will indicate whether the land qualifies for continued use on the REET affidavit.