Washington Research Council
= Special Report = February 1, 1993

# Real Estate Excise Taxes in Washington State

## Introduction and Overview

Increasing attention has been focused on the real estate excise tax (REET) due to rising collections and tightened state and municipal budgets. The tax has been targeted by interest groups as a funding source for their programs. Legislation passed by the 1990 Legislature allows local governments to raise the tax for specific purposes.

The maximum REET rate levied in most parts of the state is 1.78 percent. That translates to $1,780 on the sale of a $100,000 house. The highest rates in the state are currently 2.78 percent in Friday Harbor, 2.03 percent in Clarkston and 2.53 percent in San Juan County.

Washington's REET is placed on the sale of real property in the state, and is paid by the seller. State government levies a REET of 1.28 percent on the value of each sale, which is estimated to generate $430.4 million for K-12 education and public works assistance during the 1991–93 biennium. The tax is a relatively minor revenue source, accounting for only about 2.7 percent ($394.2 million) of total general fund-state revenue in the current biennium.

The legislature in 1982 authorized cities and counties in Washington to impose a local–option REET at a rate not exceeding 0.25 percent. The proceeds from the tax are placed in a capital improvement fund to be used for local projects. Currently 227 of 267 cities and 30 of 39 counties impose the 0.25 percent REET.

In 1990 the Washington state legislature passed the Growth Management Act (GMA), which placed restrictions on the uses of any local-option REET revenues in those counties and cities required or choosing to adopt GMA. The act also authorized cities and counties required to plan under GMA to impose a REET of 0.25 percent in addition to any existing local options. Those cities and counties which choose, but are not required, to plan under GMA may also levy the tax, but not without voter approval. Revenues from this REET are to be used for capital projects in any GMA comprehensive plan.

In 1992 the legislature narrowed the list of capital projects that could be funded by proceeds from any REET levied under the 1982 act in counties or cities with populations in excess of 5,000. The same act further restricted the kinds of capital projects that any city or county, whatever their size, may fund through the additional GMA local-option.

Counties planning under the GMA may also impose a REET of up to 1 percent for the acquisition and maintenance of conservation areas.

The REET is a highly volatile revenue source, reacting strongly to fluctuations in the economy and real estate market. Total collections rose by 55 percent in the 1989-91 biennium before falling by 15 percent in 1991-93. The unreliability of REET collections makes it a poor choice for earmarking for other than one-time capital purposes.

Washington taxes real estate transfers more heavily than most other states. The REET adds significantly to closing costs, especially at the higher, local-option rates, and may pose an obstacle to first-time home buyers.

In the pages that follow, we examine the history of the real estate excise tax in Washington, the amounts and uses of the revenue it generates, how it compares to real estate taxes in other parts of the country, and the general characteristics of the tax, including its elasticity, stability and proportionality.

## Washington's Real Estate Transfer Taxes

State government in Washington, together with cities and counties, is authorized to levy taxes on transfers of real property. The first transfer tax was a state conveyance tax which was levied from 1935 to 1987. The real estate excise tax (REET) was authorized as a local tax in 1951, and became a state tax in 1981. Since then, several local-option REETs have been authorized for cities and counties. What follows is a brief history of those taxes and a discussion of the revenues they produce and the uses made of them.

### Conveyance Tax

The conveyance tax was introduced in Washington as part of the Revenue Act of 1935, which forms the basis of much of the state's current tax system. The initial rate was 50 cents per $500 (0.1 percent) of value on transfers of real property by deed or other written instrument. Revenue generated by the conveyance tax was deposited in the general fund-state account. Transfers by the state of Washington were exempted from the tax in 1945.

Surtaxes were imposed on the conveyance tax during the 1982 recession, and in 1983 the temporary rate of 53.5 cents per $500 of value was made permanent.

The legislature increased the rate to $1.00 per $500 in 1985, and dedicated the increase to the state's public works assistance account. Money in the account was used to guarantee and make loans for local government public works projects.

The conveyance tax was administered until 1987 through the use of tax stamps sold by the Department of Revenue. The tax was collected locally by county auditors and land title companies, who affixed the stamps to the appropriate documents at the time of transfer.

A 1966 report of the state Tax Advisory Council recommended that the tax be terminated, stating that "the compliance cost to the taxpayers of the state is disproportionate to the amount of revenue produced by the state. If the stamp is removed, the tax compliance relating to real estate transfers will be greatly simplified."

The conveyance tax was eliminated on May 18, 1987, and the state REET increased to recapture lost revenue.

## Real Estate Excise Tax

Local governments in Washington were authorized in 1951 to levy a REET of up to 1 percent on the sale of real property as a revenue source for local schools.

The 1980 Legislature changed the REET from a local option to a state tax, effective Sept. 1, 1981. This change was made in order to help implement the Basic Education Act, which placed the responsibility for funding basic education on state government.

A surtax of 4 percent was added to the state REET in 1982 as one of a number of tax increases imposed during the recession of the early 1980s. The surtax was increased to 7 percent on Aug. 1, 1982, and was to expire on June 30, 1983. In 1983, however, it was made permanent, making the state REET rate 1.07 percent.

The state REET was further increased to 1.28 percent to replace revenue lost, both in the general fund-state and public works assistance accounts, when the conveyance tax was repealed in 1987.

An additional temporary, two–year increase of 0.06 percent in the REET was adopted in 1987, bringing the rate to 1.34 percent. The surtax raised about $15 million for purchases of natural resource conservation areas by the Department of Natural Resources, including Woodard Bay in Thurston County, Willapa Divide in Pacific County and Cypress Island in Skagit County. This temporary increase expired June 30, 1989, and the rate returned to 1.28 percent.

**Table 1**

**Real Estate Excise Taxes in Washington**

(maximum authorizations)

| | Rate | Taxes Due on $100,000 Home |
|---|---|---|
| State tax | 1.28% | $1,280 |
| Local–option taxes | 2.00 | 2,000 |
| *For capital purposes* | *0.25* | *250* |
| *Associated with growth management*[1] | *0.25* | *250* |
| *Conservation purchases*[2] | *1.00* | *1,000* |
| *In lieu of sales tax*[3] | *0.50* | *500* |
| Total authorized | 3.28% | $3,280 |

1. Voter approval is necessary in counties not required to plan under the state's 1990 Growth Management Act.
2. Requires voter approval. Adopted only in San Juan County.
3. Clarkston is the only jurisdiction imposing this option. Given the stability of the sales tax and the amount of revenue it generates, this tax option is not likely to be imposed by other jurisdictions under normal circumstances. References to maximum rates and cost on home sales do not include the impact of this option.

## REET Made a Local Option in 1982

Cities and counties were given the option of levying a local REET of 0.25 percent in 1982 to pay for improvements listed under the local improvement district authorization (LIDs). This tax is in lieu of the authority to tax or charge impact fees for land development and building construction, and does not require local voter approval. Cities may impose the tax only within municipal boundaries, counties only within unincorporated areas.

Local governments in Kitsap, Pierce and Snohomish counties began levying the additional tax in 1982. As of September 1992, 227 of the state's 267 cities and 30 of 39 counties levied the tax.

Cities and counties also have the option of levying a REET of up to 0.5 percent in lieu of their second 0.5 percent local–option sales tax. This tax does not require voter approval. Clarkston is the only jurisdiction to levy this option, and it is unlikely that other jurisdictions will choose it under normal circumstances given the stability of the sales tax and the amount of revenue it generates.

## 1990 Changes in Washington's Real Estate Excise Tax

The last major changes in Washington's real estate excise tax came in 1990, when the legislature authorized cities and counties to levy additional local–option REETs for capital projects and conservation areas under the state's new Growth Management Act. These changes brought the tax up to its current maximum authorization.

## Funding for Conservation Areas

The 1990 Legislature gave counties planning under the Growth Management Act the authority to impose a county-wide REET of up to 1 percent to fund the acquisition and maintenance of conservation areas.

Voter approval must be obtained in order to levy the tax. The tax may be initiated by the county commissioners or by a petition signed by 10 percent of the total number of voters voting in the last county election. The act requires that the county prepare an expenditure plan in consultation with cities and that the funds be spent in conformance with the plan.

This particular local option, unlike the other local-option REETs, is imposed on the buyer rather than the seller. According to state Sen. Dan McDonald (R–Bellevue), the legislature's intent was to more directly tax property purchasers who are adding to growth, and to use the money generated for the preservation of open space.

***The real estate excise tax has been one of the fastest-growing sources of state revenue in recent years.***

At the time it was adopted, the Department of Revenue estimated that the one percent conservation REET could generate up to $160 million a year if it were levied by all counties. Thus far, however, only San Juan County has adopted this tax.

## Growth Management

The state's Growth Management Act requires 15 fast–growing counties and the cities therein to adopt comprehensive land–use plans and development regulations. The mandate currently applies to Chelan, Clallam, Clark, Island, Jefferson, Kitsap, King, Mason, Pierce, San Juan, Skagit, Snohomish, Thurston, Whatcom and Yakima counties. Other counties and cities may choose to plan under the act.

Local governments that plan under GMA may use the 0.25 percent local–option REET authorized by the 1982 law only for specific capital projects listed in the capital facilities element of their comprehensive plan or for housing relocation assistance. The capital projects list that can be funded by REET proceeds remains the same for those cities and counties not choosing to plan under the act.

Local governments that plan under GMA may require that housing relocation assistance be provided to low–income residents who are dislocated as a direct result of new development. The cost of assistance may not exceed $2,000 per household, and is shared by the developer and the local government.

A new 0.25 percent local-option REET was authorized in 1990 to help carry out the purposes by the Growth Management Act. This GMA REET increment may be imposed without voter approval by cities and counties that are required to plan under the act. Revenue generated by the tax is to be used by these local governments solely for financing the capital projects specified in the capital facilities portions of their comprehensive plans. Cities and counties that choose, but are not required, to plan under GMA may also impose the tax, but only with voter approval.

The tax is placed on each sale of real property in unincorporated areas of the county for the county tax and in the corporate limits of the city for the city tax. The GMA REET, like the first 0.25 percent local–option REET, is imposed on the seller of the property.

As of October 1992, 39 cities and four counties had adopted the GMA increment, and thus levied combined REETs of 1.78 percent or more.

Cities and counties that plan under the growth management act are also authorized to charge impact fees on new development. Cities and counties had only limited power to change impact fees in the early 1980s, when the original local-option REET was authorized.

## Uses of REET Restricted Further in 1992

In 1992 the legislature passed Bill 6408 (Chapter 221, Laws of 1992), which restricted the list of capital projects that could be funded by proceeds from any REET levied under the 1982 act in cities or counties with populations in excess of 5,000. The bill was introduced in response to concerns that the types of capital projects being funded by REET proceeds may not have been consistent with the intent of the authorizing legislation.

Under the act, cities and counties may fund only capital facilities, capital projects such as sewers, streets, bridges, traffic signals, street lights, sidewalks, and trails, and housing relocations through the local-option REET. Cities and counties under 5,000 population were not affected by the bill.

The same act also clarified the limitations on the kinds of capital expenditures that any city or county, whatever its size, may fund through the additional GMA local-option REET. Under its provisions, recreational facilities, trails, libraries, judicial, fire protection, administrative and law enforcement facilities, and river or waterway flood control projects will not be considered eligible uses of these revenues.

## Uses of the Tax

The REET is collected by county treasurers who disburse the money to the state and to the cities within the counties that are exercising their local options.

REET collections are estimated at almost $430.4 million in the 1991–93 biennium. About 91.6 percent of the total goes to the general fund-state account to help support public schools. The public works assistance account receives about 7.8 percent of the state's collections, or about $33.5 million for 1991–93. County governments retain 1 percent to cover the

**Table 2**

## Real Estate Excise Tax Collections

| County | Fiscal Year 1992 State | Fiscal Year 1992 Local[1] | Fiscal Year 1992 Total | Percent of FY 92 Total | Inflation-Adjusted Percent Change FY 89 Total |
|---|---|---|---|---|---|
| Adams | 319,725 | 58,933 | 378,658 | 0.2% | 67.7% |
| Asotin | 409,847 | 122,580 | 532,427 | 0.2% | 68.3% |
| Benton | 3,930,795 | 755,312 | 4,686,107 | 1.9% | 97.7% |
| Chelan | 2,217,529 | 432,808 | 2,650,337 | 1.1% | 46.1% |
| Clallam | 2,364,736 | 461,998 | 2,826,734 | 1.1% | 3.4% |
| Clark | 10,313,705 | 2,010,177 | 12,323,882 | 5.0% | 18.9% |
| Columbia | 86,189 | 16,545 | 102,733 | 0.0% | 14.9% |
| Cowlitz | 1,937,174 | 184,221 | 2,121,395 | 0.9% | (8.8%) |
| Douglas | 898,289 | 175,307 | 1,073,596 | 0.4% | 1.0% |
| Ferry | 168,251 | 32,889 | 201,140 | 0.1% | (7.6%) |
| Franklin | 700,287 | 136,864 | 837,151 | 0.3% | 11.3% |
| Garfield | 54,571 | 9,902 | 64,473 | 0.0% | 251.8% |
| Grant | 1,419,051 | 103,315 | 1,522,367 | 0.6% | 32.2% |
| Grays Harbor | 1,507,007 | 292,981 | 1,799,988 | 0.7% | (6.1%) |
| Island | 2,728,932 | 801,171 | 3,530,103 | 1.4% | 8.4% |
| Jefferson | 1,601,836 | 355,801 | 1,957,637 | 0.8% | 0.5% |
| King | 69,698,696 | 14,332,237 | 84,030,934 | 33.9% | (32.4%) |
| Kitsap | 8,230,519 | 3,091,276 | 11,321,795 | 4.6% | 52.0% |
| Kittitas | 912,829 | 178,372 | 1,091,201 | 0.4% | (53.6%) |
| Klickitat | 479,124 | 93,516 | 572,640 | 0.2% | 26.2% |
| Lewis | 1,609,882 | 96,522 | 1,706,404 | 0.7% | (11.5%) |
| Lincoln | 249,905 | 40,889 | 290,794 | 0.1% | 20.1% |
| Mason | 1,567,420 | 33,900 | 1,601,320 | 0.6% | (38.2%) |
| Okanogan | 901,023 | 164,290 | 1,065,313 | 0.4% | (18.9%) |
| Pacific | 725,231 | 142,990 | 868,222 | 0.4% | (50.0%) |
| Pend Oreille | 311,988 | 7,899 | 319,887 | 0.1% | (27.3%) |
| Pierce | 21,726,732 | 5,553,190 | 27,279,922 | 11.0% | 26.5% |
| San Juan | 1,130,701 | 1,082,850 | 2,213,551 | 0.9% | 15.0% |
| Skagit | 3,692,806 | 827,908 | 4,520,714 | 1.8% | 18.8% |
| Skamania | 237,267 | 4,067 | 241,333 | 0.1% | (36.4%) |
| Snohomish | 24,858,327 | 8,215,732 | 33,074,060 | 13.3% | (0.1%) |
| Spokane | 12,561,801 | 2,444,514 | 15,006,315 | 6.1% | 53.6% |
| Stevens | 1,095,347 | 39,296 | 1,134,643 | 0.5% | 45.6% |
| Thurston | 6,988,621 | 1,997,720 | 8,986,341 | 3.6% | 28.4% |
| Wahkiakum | 129,116 | 0 | 129,116 | 0.1% | 21.2% |
| Walla Walla | 1,101,614 | 3,756 | 1,105,369 | 0.4% | 38.5% |
| Whatcom | 7,661,707 | 1,732,252 | 9,393,959 | 3.8% | (9.9%) |
| Whitman | 656,561 | 126,337 | 782,898 | 0.3% | 23.2% |
| Yakima | 3,882,587 | 711,871 | 4,594,458 | 1.9% | 15.1% |
| Total | 201,067,729 | 46,872,188 | 247,939,917 | 100.0% | (7.3%) |

1. Does not include amounts retained by counties for collection costs.

*Source: Washington Research Council, based on Washington State Department of Revenue records.*

cost of collecting the tax.

As noted above, local governments' use of the local–option REET is also limited by state law. With the exception of the option levied in lieu of the second half–cent sales tax, the local–option taxes may be used for capital projects, housing relocation assistance or conservation area acquisition.

## Excise Taxation Serves Many Purposes

Excise taxes are taxes on the sales of selected items, such as gasoline, liquor and tobacco. According to Thomas F. Pogue in *Reforming State Tax Systems*, excise taxes may be intended to serve purposes in addition to raising revenue, and "any evaluation of excise taxation must be based on views about what the taxation is supposed to accomplish. Whether a particular excise tax is suitable on equity, efficiency, or other grounds will depend on the purposes that it is regarded as serving."

Pogue identifies the following rationales for excise taxation:

- **User Charges**. An excise tax may be a charge for government services, where a direct link exists between the perceived benefits and the taxes collected. Under this rationale, the revenue source is dedicated, or "earmarked," for a particular program.

  A common example of this is the use of gas tax revenue to fund highway programs.

> ***"Any evaluation of excise taxation must be based on views about what the taxation is supposed to accomplish."***
>
> ***— Pogue***

- **Sumptuary Taxes**. An excise tax may be used to discourage the consumption of a particular commodity on the grounds that consumption of the taxed commodity is socially undesirable. This justification is frequently offered for taxes on alcohol and tobacco products.

- **Charges for Social Costs**. A tax may be levied to make up for the external social costs associated with consumption of a commodity. In this case, discouraging consumption is not the primary purpose of the tax, although a reduction in consumption may result. The purpose, instead, is to force buyers to recognize the full social cost of their decision to use the product.

  The classic example cited by Pogue is taxes on products that generate pollution, such as large or high–horsepower cars. Washington has a litter control tax, in which manufacturers, wholesalers and retailers pay a tax on the value of certain products, including containers, groceries, newspapers and magazines. The funds generated by the tax are used for anti–litter and recycling programs.

  Washington's recently authorized local–option REETs for conservation area acquisition and capital financing, as well as the state portion of the tax dedicated to the public works assistance account, fall into this category. The tax revenues are used to support programs that could be seen as minimizing the impact of growth.

- **Low–Distortion Revenue Source.** One general goal of tax policy is to raise revenue with a minimum distortion of producer and consumer decisions. According to Pogue, this goal is best served by relatively heavy taxation of goods for which demand is relatively unaffected by price, like cigarettes, alcohol and gasoline, and relatively light taxation of goods for which demand varies more closely with price.

### Earmarking Excise Taxes

Excise taxes are often earmarked for particular programs. As mentioned above, this may take the form of a user charge, where the revenue source has a direct link to the object of the spending program.

Earmarking is often sought by groups seeking a dedicated source of funds in order to avoid having to compete in the regular budget process. Current proposals to fund extended health care coverage through increased excise taxes on tobacco products are a recent example of this in Washington.

Without a direct linkage between user fee and user benefit, earmarking, because it reduces a legislature's ability to set priorities among competing demands on state resources, should always be viewed with caution.

***For those interested in taxes, the Research Council has additional publications available. For details, contact the Research Council office at (206) 357-6643 or (800) 445-1086.***

## Real Estate Excise Tax Collections

State, city and county governments in Washington collected $247.9 million in real estate excise taxes in FY 92 (see table 2, page 4). This was 7.3 percent less than FY 89 collections, after adjusting for inflation. Collections from King, Pierce and Snohomish counties accounted for 58.2 percent of total FY 92 collections.

### Recent Trends in State Collections

The REET has been one of the fastest-growing sources of general fund-state revenue in recent years. State government received $201.1 million, or 81.1 percent of total state and local collections in FY 92, an increase of 99.5 percent over FY 76 collections after adjusting for inflation. Figure 1 traces total state REET collections between FY 76 and FY 91, with estimates for FY 92 and FY 93.

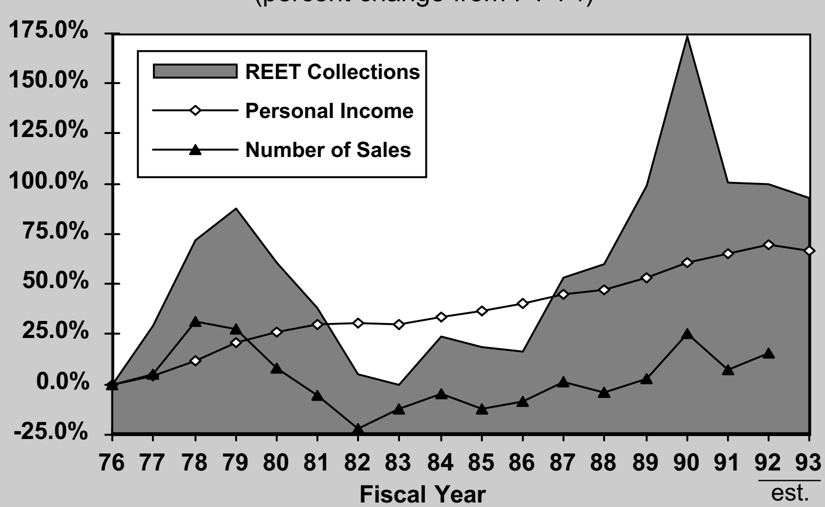
***A high rate and a broad base place Washington's REET among the highest property transfer taxes in the nation.***

General Fund-State REET collections soared to $436.8 million during the 1989–91 biennium, 55.5 percent more than 1987–89 collections of $280.9 million. Collections in the 1991-93 biennium are estimated at $394.2 million, a 9.8 percent decline from 1989-91. Nonetheless, the 1991-93 estimate is still 40.3 percent greater than collections of just four years before.

### Central Puget Sound Dominates

As shown in Table 2, most of the state and local revenue generated by the REET comes from transactions in the central Puget Sound counties. In FY 92, King County generated 34.7 percent of state REET revenue from 22.4 percent of the total number of transactions. Snohomish County accounted for 12.4 percent of total state receipts from 8.2 percent of transactions, and Pierce County 10.8 percent from 10.3 percent of transactions. Spokane County, with the second-largest population in the state, accounted for 6.2 percent of REET receipts in FY 92 and 7.9 percent of transactions.

**Figure 1**
**State Real Estate Excise Tax Collections**
(percent change from FY 74)




Note: Taxes and personal income are adjusted for inflation.
*Source: Washington State Department of Revenue.*

### Cities, Counties Benefit From Tax

The REET generated almost $46.9 million for cities and counties in Washington during FY 92. This represents an inflation–adjusted increase of 16.5 percent over FY 89. Together, local governments in King, Pierce and Snohomish counties accounted for $28.1 million, or about 60 percent, of local REET collections in FY 92.

### Factors Affecting Collections

The number of transactions made and the value of the property sold directly affect the amount revenue generated by the REET. As shown in figure 1, annual changes in tax collections track closely the number of real estate sales.

Interest rates have an indirect effect on REET receipts. According to Gordon Folkman of the Minnesota Department of Revenue, a model developed to forecast receipts from his state's mortgage and deed taxes shows that when interest rates fall, mortgage and deed tax collections tend to increase.

Folkman added, however, that "the relationship between the change in interest rates and (mortgage and deed) tax collections is relatively unstable, and is not very useful by itself to reliably predict these tax revenues."

### Some Transactions Exempt

Certain types of property are exempt from state and local REETs. Property acquired from or sold to a government entity is not taxed, nor are cemetery plots or property acquired by inheritance, gift, divorce decree or condemnation. These exemptions have an estimated state-local revenue impact of $318.5 million for the 1991–93 biennium.

### Transfers of Business Property

Under state law, the real estate excise tax is applied only when a sale of real property occurs. Changes of ownership of realty that occur without "valuable consideration" are not subject to the tax. Concerns have arisen that existing law may allow business corporations to acquire real property through stock transfers rather than through real estate sales, with the effect of

**Table 3**

**Real Estate Transfer Taxes: 1992**

(rates in percent of value)

| | Transfer Tax | Mortgage Tax | Local Taxes Levied |
|---|---|---|---|
| Alabama | 0.10%[1] | 0.15% | — |
| Arizona | — | — | — |
| Arkansas | 0.22 | — | — |
| California | — | 0.11 | x[1] |
| Colorado | 0.01 | — | — |
| Connecticut | 0.61[2] | — | — |
| Delaware | 2.00 | — | x |
| District of Columbia | 1.10 | 1.10 | — |
| Florida | 0.70 | 0.35 | x[3] |
| Georgia | 0.10[1] | — | — |
| Hawaii | 0.05 | — | — |
| Illinois | 0.10 | — | x |
| Iowa | 0.11 | 0.16 | — |
| Kansas | 0.26 | — | — |
| Kentucky | 0.10 | — | — |
| Louisiana | — | — | x |
| Maine | 0.44[4] | — | — |
| Maryland | 0.50[5] | — | x |
| Massachusetts | 0.40[1] | — | x |
| Michigan | 0.11[6] | — | — |
| Minnesota | 0.33[1] | 0.23 | — |
| Nebraska | 0.15 | — | — |
| Nevada | 0.13[1] | 0.12 | — |
| New Hampshire | 1.05[7] | — | — |
| New Jersey | 0.35[8] | — | — |
| New York | 0.40[1,9] | 1.00 | x |
| North Carolina | 0.10[1] | 0.20 | x |
| Ohio | — | — | x |
| Oklahoma | 0.15[1] | 0.10[10] | — |
| Pennsylvania | 1.00 | — | x |
| Rhode Island | 0.28 | — | x |
| South Carolina | 0.26[1] | 0.11 | x |
| South Dakota | 0.10 | — | — |
| Tennessee | 0.33[1] | 0.12 | — |
| Vermont | 0.50[11] | — | — |
| Virginia | 0.10[1,12] | 0.15 | x |
| **Washington** | **1.28** | **—** | **x** |
| West Virginia | 0.22 | — | x |
| Wisconsin | 0.30 | — | — |

Note: Transfer taxes are generally paid by the seller, mortgage taxes by the buyer. Most states grant a variety of exemptions. See CCH *Tax Guide* for detail. Alaska, Idaho, Indiana, Mississippi, Missouri, Montana, New Mexico, North Dakota, Oregon, Texas, Utah and Wyoming do not levy real estate transfer taxes.

1. Part or all of tax base is sale price less value of mortgage.
2. Rate is 0.50% for residential property valued at less than $800,000, plus 0.11% surtax. Rate is 1% on value over $800,000, and 1% on nonresidential property.
3. Local surtax does not apply to single family residences.
4. 0.22% tax levied on both buyer and seller.
5. First $30,000 of owner–occupied residential property is exempt from state tax.
6. Rate is 0.15% in counties with population over 2 million.
7. 0.525% tax levied on both buyer and seller. Rate reduced to 0.35% 6/30/93.
8. Additional tax of 0.15% is levied on sales over $150,000.
9. Additional tax of 1% levied on residential property valued at more than $1 million.
10. Rate for mortgages of 5 years or more. Lower rate for shorter periods.
11. Rate for residential property valued less than 100,000. Value above $100,000 taxed at 1.25%. Rate is 1.25% on non–residential property.
12. Rate declines on property worth more than $10 million.

*Sources: Advisory Committee on Intergovernmental Relations and Commerce Clearing House.*

avoiding payment of the REET.

Legislation was enacted in 1991 to address this issue. Bill 1831 (Chapter 22, Laws of 1991) applied the real estate excise tax to any transfers of corporate ownership deemed comparable to sales of real property, so long as these transactions met certain conditions. This change in the REET has been found difficult to interpret and administer.

As part of his 1992 supplemental budget plan, Governor Booth Gardner proposed to eliminate this problem by restructuring the real estate excise tax as a conveyance tax. Under this approach the tax would be imposed on all transfers involving the real estate deed, with a few standard exemptions, rather than just on those resulting from sales. According to the governor, this change would increase tax revenues to the state by about $9 million. This approach to taxation of real property transfers was found to be too broad, however, and was not approved by the legislature.

## Real Estate Transfer Taxes Around the Country

A 1988 study of real estate transfer taxes conducted by Price Waterhouse for the National Association of Realtors identifies four types of transfer taxes. These taxes are all imposed at the time of the recording or transfer and are non–recurring. The primary difference in the taxes is the base to which they apply.

Realty transfer taxes are generally assessed on the total purchase price of property, although the base may exclude the value of the mortgage. Washington's REET falls into this category. The tax may be assessed on the seller, the buyer or both.

Mortgage taxes are assessed on the amount of the mortgage secured to purchase real property. The tax liability therefore declines as the down payment increases. Mortgage taxes are typically assessed on the party obtaining the mortgage.

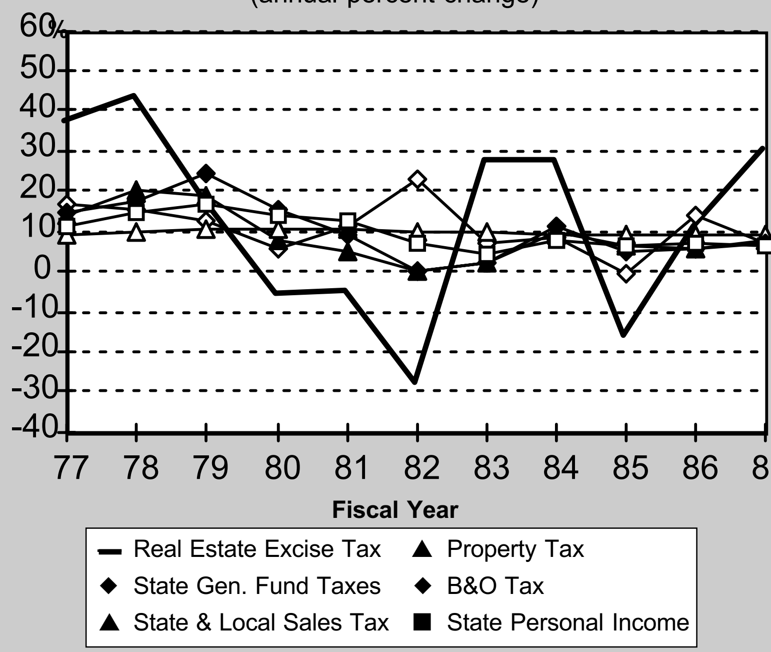
Deed recording and stamp fees are based on the value of the property or set at a fixed amount, and are generally paid by the buyer. Washington's former conveyance tax fell into this category.

Sales taxes on real estate commissions are an extension of the general sales tax on the value of a service, rather than a special tax on the transfer of property ownership. It is paid by the seller.

**Figure 2**

**Stability Comparison**

(annual percent change)




Note: Taxes are hypothetical constant rate and base estimates.

*Source: Tax Alternatives Model, Department of Revenue, 1990.*

## Rates Vary from State to State

There is wide variation among U.S. states in taxation of real estate transfers. State tax rates range from a low of 0.01 percent in Colorado to a high of 2.00 percent in Delaware. Washington's 1.28 percent rate places it second highest. (See Table 3.) The maximum rate currently levied in Washington for the combined state-local REET is 2.78 percent, with most jurisdictions levying a REET of 1.78 percent.

Caution should be exercised in making direct comparisons among real estate transfer tax rates, since tax bases vary widely from state to state. Some states tax the entire purchase price, for example, while others provide special exemptions for residential property below a certain value or tax it at a different rate.

By any comparison, however, Washington's REET stands as among the highest property transfer taxes in the nation due to its high rates and broad tax base.

***Washington's real estate excise tax is a highly volatile source of revenue. . .***

***Relying on such a volatile revenue source to fund an ongoing program should be avoided.***

## Taxes on the Increase

According to Steve Gold of the Nelson A. Rockefeller Institute of Government at the State University of New York, property transfer tax rate increases are a national trend that is likely to continue, although softening in the real estate market may cause it to slow down. At least 13 states have increased their real estate transfer taxes since 1986, according to Scott Mackey of the National Conference of State Legislatures. At least nine have raised rates since 1988.

Real estate transfer tax rate increases have been especially popular in the New England states. All of the New England states with the exception of Maine have raised the tax since 1986, according to Mackey. New Hampshire has raised the tax three times.

## Earmarking the Real Estate Excise Tax

According to the Price Waterhouse study, the earmarking of state transfer tax revenues to specific purposes is also on the rise.

At least nine states, including Washington, earmark all or part of their real estate transfer taxes, the report said. These special purposes are typically one–time or capital projects, such as land acquisition, economic development projects and low–income housing.

As discussed below, the volatility of the REET makes earmarking an important issue. REET revenue should not be used to fund ongoing operations, because REET receipts tend to vary dramatically from year to year.

## REET a Volatile Revenue Source

Washington's REET is a highly volatile source of revenue, fluctuating primarily with the number of transactions in a given year. Stability is defined here as the degree in which revenues change from year to year. Small swings in revenue growth imply greater stability than large swings.

Stability can best be illustrated by graphing revenue flows over time. Figure 2 shows the annual percent change in hypothetical collections (adjusted to reflect constant tax rates and bases) of Washington's state REET, along with annual percent changes in collections from several other state taxes. Between FY 76 and FY 87, the annual change in constant rate/base REET collections ranged from a high of 43 percent in FY 78 to a low of -29 percent in FY 82.

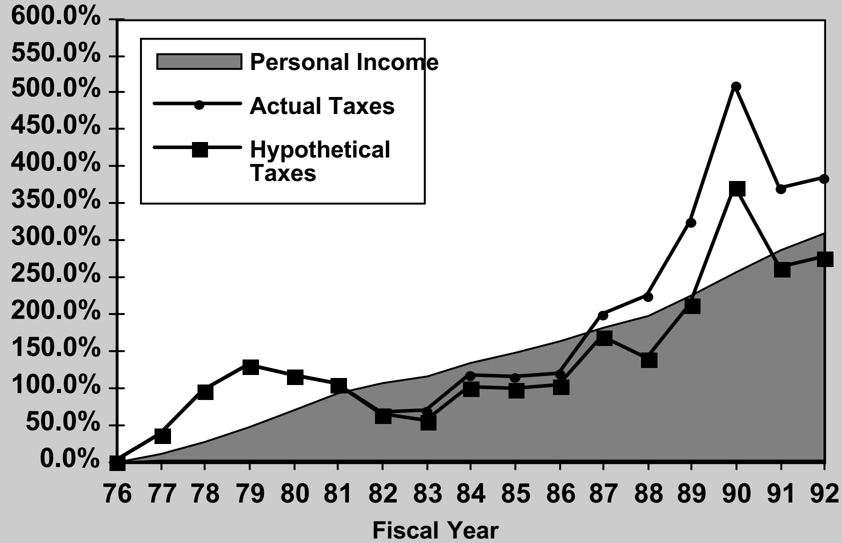
REET is a small share of total state tax revenues, so its volatility is not a major concern under normal circumstances.

Caution should be exercised, however, in earmarking the tax for a specific program. Relying on such a fluctuating revenue source to fund an ongoing program requiring a regular flow of revenue should be avoided. Earmarking the REET for one–time expenses such as land acquisition or capital construction, as Washington has generally done, is less of a problem.

**Figure 3**

**Real Estate Excise Tax and Economic Growth**

(percent change from FY 76)




Hypothetical taxes represent constant rate and base estimates.

*Source: Tax Alternatives Model, Department of Revenue, 1990.*

## REET and the Economy

The REET does not demonstrate a close relationship to growth in the state's economy. This relationship, called elasticity, is important in evaluating the performance and determining the appropriate uses of a revenue source.

Elasticity is measured by dividing the percent change in taxes by the percent change in total state personal income using collections estimates that assume constant tax rates and bases. The closer the elasticity is to one, the closer the relationship between the economy and tax collections.

REET had an elasticity of 0.890 between FY 76 and FY 92, indicating that collections ran behind growth in the economy over this time. This measure, however, does not reflect extreme peaks and valleys in the intervening years, as shown in figure 3. The high during this period, for example, was 5.039 in FY 90, and the low was –2.872 in FY 91.

***"Whether a regressive excise tax is inequitable depends on its purpose. . . A tax is fair if it is distributed among taxpayers according to the benefits they receive. . ."***

***— Thomas F. Pogue***

The key to reading this graph is to compare the relative slopes of the tax lines with personal income, an indicator of economic growth. When the slopes of the lines are parallel, elasticities are equal to one.

During the recession of the early 1980s and in some subsequent years, hypothetical REET collections actually declined (reflecting the volatility of the real estate market), while the economy continued to grow. After a collections boom in FY 90, receipts lagged well behind economic growth each of the last two years. REET collections grew faster than the economy during other periods shown.

## Proportionality

The question of proportionality, or how the tax affects people with differing incomes, often arises when a tax is evaluated. It is necessary to consider a number of issues when looking at the proportionality of the REET.

According to Thomas F. Pogue in *Reforming State Tax Systems*, the distribution of excise tax burdens among different income classes is generally regarded as regressive. In other words, tax burdens make up a larger share of income for lower–income households than they do for higher–income households.

Price Waterhouse agrees. Price Waterhouse cites data showing housing payments declining as a percentage of income as income increases in transactions involving the REET. Since most property transfer taxes are assessed as a uniform percentage of the value of the property, tax payments as a percentage of income also decrease as income increases.

Price Waterhouse also considered the frequency with which households buy new homes. People at higher income levels tend to move slightly more frequently than those at lower income levels. As a result, higher–income households pay the tax more often. Even after taking this factor into account, however, the tax is still "highly regressive," according to Price Waterhouse.

Other factors that affect the proportionality of the tax include the amount of property owned, particularly for households at the upper end of the income scale, and changes in household income over the life of the purchase. These factors are difficult to quantify. For example, high-income households are more likely to own more than one piece of property for second homes, vacation homes or investments. They are therefore more likely to incur liability for the tax more than once.

In some cases, the transfer tax is included in the financing package and capitalized over the life of the mortgage. Household income is likely to increase over the period of the mortgage. The tax therefore represents a changing percentage of income.

Pogue notes that "whether a regressive excise tax is inequitable depends on its purpose." As a source of general revenue, a tax may be seen as unfair. "As a user charge, however, a tax is fair if it is distributed among taxpayers according to the benefits they receive from the service(s) for which the tax is a user charge or according to the costs they generate as they make use of the service(s)," he states. "The regressivity of the tax in this case does not prevent it from being equitable."

> ***As long as the tax is at a relatively low rate, it is. . . relatively painless. However, the rate in Washington is higher than what would be considered relatively low.***
> ***— Steve Gold***

Pogue goes on to say that when the purpose of a tax is to limit or discourage a particular activity or to internalize external social costs, regressivity is not a pertinent issue. It merely indicates that expenditures on the products whose purchase is to be discouraged do not increase in proportion to increases in income.

In the case of the Washington REET, portions of the proceeds from the tax are used as a charge for the social costs of growth and increasing demands on local government infrastructure. Following Pogue's argument, these components of the tax should not be included in a consideration of its regressivity.

### Impact on Home Buyers

Perhaps more important than the proportionality of the REET is its impact on prospective home buyers. Does the relatively heavy taxation of real estate transfers in Washington have the effect of keeping first-time and lower-income buyers out of the market?

According to Michael Schuyler of the Institute for Research on the Economics of Taxation, transfer taxes tend to discourage the purchase of real estate, especially at higher rates.

The 1990 Legislature authorized cities and counties to levy up to an additional 1.25 percent REET: not more than 1.00 percent on the buyer for conservation area purchases, and 0.25 percent on the seller for counties required or electing to plan under the Growth Management Act.

During legislative hearings on these new authorizations, the Washington Association of Realtors and others expressed concern about the effect the added taxes would have on the ability of consumers to purchase homes. The issue is of particular importance as it relates to the new 1 percent local-option REET, which is imposed directly on the buyer.

Closing costs, which include real estate transfer taxes, are an important consideration for prospective home buyers, the Price Waterhouse study says. The higher the tax, the greater a factor they become in housing affordability.

Closing (or settlement) costs include such items as loan fees, appraisal fees, credit reports, mortgage insurance and

## Bibliography


Advisory Commission on Intergovernmental Relations. *Significant Features of Fiscal Federalism. Volume 1: Budget Processes and Tax Systems*. September 1992.

Clatanoff, Robert M. *Patterns of Property Tax Administration in the United States*. International Association of Assessing Officers, June 1986.

Commerce Clearing House Inc.
*State Tax Guide,* 1992.
*State Tax Handbook,* 1989.

Cousins, Kurt. "Housing Affordability in Philadelphia: The Effect of the Realty Transfer Tax Increase," *The Residential Real Estate Market in Philadelphia*. Philadelphia Board of Realtors, 1990.

Fisher, Ronald C. *State and Local Public Finance*. Scott, Foresman and Co., 1988.

Folkman, Gordon and John Peloquin. *Minnesota's Mortgage and Deed Tax: Recent Legislative Changes and Implications for State Budgeting*. Minnesota Tax Revenue and Policy Review, November 1987.

Pogue, Thomas F. "Excise Taxes," in Steven D. Gold, ed., *Reforming State Tax Systems*. National Conference of State Legislatures, December 1986.

Price Waterhouse. *Analysis of State and Local Real Estate Transfer Taxes*. Prepared for the National Association of Realtors, August 1988.

Washington Research Council. *Understanding Washington's Taxes.* October 1988.

Washington State Department of Revenue.
*Tax Alternatives Model,* 1990.
*Tax Exemptions*, January 1992.
*Tax Reference Manual,* January 1991.
*Tax Statistics,* various years.

Washington State Senate, Ways and Means Committee. *Washington State Taxes in a Nutshell, 4th edition*. September 1987.

Woo, Mai and David Raboy. *The Economic Effects of Selective Excise Taxes*. Institute for Research on the Economics of Taxation, October 1981.

taxes. These costs typically run between 4 and 8 percent of the property value, depending on the size of the down payment and the type of loan.

Closing costs must be paid in a lump sum when the house is purchased. They therefore cut into the funds that would otherwise be available for a down payment, which is a major obstacle for many prospective first–time home buyers.

Gold contends that as long as the transfer tax is at a relatively low rate, it is such a small percentage of the transaction costs that it is relatively painless. The rate in Washington, however, is higher than what Gold would consider "relatively low."

Because of its high rate, Washington's REET has a significant impact on home purchases, especially those of first-time home buyers trying to accumulate the savings needed for the down payment. The taxes due in Washington may require people to wait longer than they would have otherwise before purchasing a home, or to purchase a lower–priced home. Moreover, if housing prices are rising rapidly or there are few homes available in an affordable price range — as has been the case in many areas in recent years — the potential home purchaser could be precluded from buying a home in a particular housing market.

***That additional $1,000 (in REET payments) could be the difference between buying a house or not.***

***— Kim Herman***

According to Kim Herman of the Washington State Housing Finance Commission, the recently authorized 1 percent local-option REET for acquisition and maintenance of conservation areas could have a major impact on first–time home buyers were it adopted more widely. Once a family has found a home it can afford in terms of its monthly payments, the next hurdle is having the cash necessary for closing costs, he said.

Closing costs of 6 percent, for example, mean that the buyer would have to come up with $6,000, in addition to the down payment, on a $100,000 home. The new 1 percent local–option REET would add $1,000 to these closing costs, bumping them up to 7 percent of the sales price, or $7,000.

That additional $1,000 could be the difference between buying a house or not, Herman said.

Transfer taxes adversely affect the ability of all consumers to purchase homes, says David Porter, a Puget Sound-area mortgage lender and real estate educator, but especially the first-time buyer.

"With interest rates at about a 20-year low, home affordability will never be better," Porter says. "But rate is not the only key — costs to get in the home are paramount. An increase in the buyer's costs by means of an increase in the (real estate) excise tax would limit home buyers — both first-time buyers and people with hopes of buying up."

Several states attempt to mitigate the effect of transfer taxes on home purchases through special features of their taxes. These include exempting all or a portion of residential property from the tax, taxing it at a differential rate, or taxing lower-priced properties at lower rates.

## Summary and Conclusions

Washington's real estate excise tax has been one of the state's fastest growing revenue sources in recent years. With this growth has come increased attention on the tax as a way of funding particular programs and activities.

The REET is a highly volatile revenue source. The relative inelasticity of the REET causes it to exaggerate tendencies toward slow revenue collections during economic downturns and rapid collections during economic booms.

This volatility is not a major concern when considering it as a source of general revenues, because its proceeds only make up a small portion of the general fund-state account.

Excise taxes are often, however, earmarked for specific purposes. Because of its volatility, the REET is not a good source of revenue for programs requiring ongoing funding. To the extent that the REET is earmarked, it should be for programs which require one–time appropriations, such as capital projects or property acquisition. This is currently the case in Washington.

As with other excise taxes, the tax is probably regressive. In other words, it may take a larger portion of the income of lower–income households than of higher–income households. As Pogue notes, however, the service benefits of the tax as well as its payers needs to be considered in any consideration of its equity.

A more important issue is whether the tax may keep first–time home buyers out of the housing market. There may be a significant impact on lower–income home buyers if the tax adds significantly to the cash cost of closing a home purchases. Some states have attempted to mitigate this effect through special features of their transfer taxes.

Data on the revenue produced by cities and counties through local–option REETs is not easily obtainable. There are now several local REET authorities and a variety of purposes for which the revenue can be used. As the legislature passes more and more taxing authority to local governments, it will be increasingly important to have reliable and comparable figures on the revenue each tax generates for specific local jurisdictions and the purposes for which the taxes are being levied.

# About the Washington Research Council

The **Washington Research Council** is a nonprofit, non-governmental public policy research organization. Its mission is to serve its members by promoting efficient government and effective public policy through independent and objective fiscal analysis of important policy questions and through broad communications of its findings. Funding for the **Research Council's** work comes primarily from member dues and private grants. Members include businesses, schools, libraries, individuals and government agencies.

You can share in the **Washington Research Council's** constructive work and contribute to improved government through your investment in a tax deductible membership.

As a **Research Council** member you will receive the *Notebook* newsletter, up-to-date information and analyses of tax and spending issues through our *Public Policy Briefs*, special reports, and major **Research Council** publications, including *How Washington Compares*, *Washington State Fiscal Trends*, *and The Citizens' Guide to School Districts.*

For membership information call (206) 357-6643 or (800 445-1086), or write to the **Washington Research Council**, 906 S. Columbia, Suite 350, Olympia, WA 98501.

---

This special report is a revision of a report originally done in August 1990. Financial support was provided by the Washington Association of Realtors.

The Washington Research Council would like to thank the people who contributed to the preparation of this publication. They include **Chuck Gusak** of the state Economic and Revenue Forecast Council, **Rick Peterson** of the House Revenue Committee, **Tom Reeves** of the state Department of Revenue, **Steve Wells** of the state Department of Community Development, **Tom King** of the Washington State Association of Counties, and **Terri Hotvedt** of the Washington Association of Realtors.

The recommendations and conclusions in this publication are solely those of the Research Council staff and should not be attributed to the organizations and individuals that assisted with the report.

Washington Research Council staff includes **Richard S. Davis**, president, **John S. Archer**, director of research, **Kim L. Gorsuch**, research assistant, and **Laura A. Cameron**, office manager.

---

***For those interested in taxes, the Research Council has additional publications available. For details, contact the Research Council office at (206) 357-6643 or (800) 445-1086.***