Washington Research Council

ePOLICY brief

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Washington's Real Estate Excise Tax: High Rate, Volatile Stream

Washington's real estate excise tax is among the nation's highest. It generates a relatively small stream of revenue for state and local government. And, it is highly volatile, increasing and declining with the ups and downs of the real estate market. Volatility in the revenue stream increases the risk associated with relying on the tax to fund ongoing programs.

Real Estate Excise Taxes in Washington
(maximum authorizations)

	Rate	Taxes Due on $100,000 Home
State tax	1.28%	$1,280
Local taxes	2.00	2,000
For general capital purposes [1]	*0.25*	*250*
For growth-related capital projects [2]	*0.25*	*250*
Conservation purchases [3]	*1.00*	*1,000*
In lieu of sales tax [4]	*0.50*	*500*
Total authorized	3.28%	$3,280

[1] Most cities and counties impose this option.

[2] Voter approval is necessary in counties not required to plan under the state's 1990 Growth Management Act.

[3] Requires voter approval. Adopted only in San Juan County. This REET is imposed on the buyer. All others are imposed on the seller.

[4] Only a few cities impose this option.

Sources: *Real Estate Excise Tax Rates* and Tax Reference Manual, State of Washington, Department of Revenue, 1999.

Seized upon by state and local lawmakers throughout Washington as an expedient way to tap into the state's extended economic growth, the real estate excise tax makes home buying more expensive and creates an especially heavy burden for lower- and middle-income purchasers.

In Washington, transfers of real property, both residential and commercial, are subject to state and local real estate excise taxes (REET). The state imposes a 1.28 percent tax on sales and other transfers of real property. That is, for every $100,000 of a property's sales price, the state assesses $1,280 in state real estate excise tax. Sale of a median priced home in King County (about $244,450 in July of 2000) would, therefore, generate $3,129 in state real estate excise tax.

Washington's State REET One of Nation's Highest

Washington's state rate is one of the highest in the nation. Only Delaware's two percent rate is higher. Fourteen states do not tax real estate transfers at all. And in a number of other states, the tax amounts only to a minor recording fee.

Local Taxing Options Also High

Besides the high rate the state imposes, Washington also stands out as one of only 12 states that also allow local jurisdictions to tax real estate transfers. Cities and counties were given the option to levy the tax locally in 1982 at a rate of 0.25 percent in order to pay for capital projects associated with a capital facilities plan. In addition cities and counties were allowed to levy up to 0.50 percent in lieu of their second 0.5 percent local-option sales tax. In 1990 two additional

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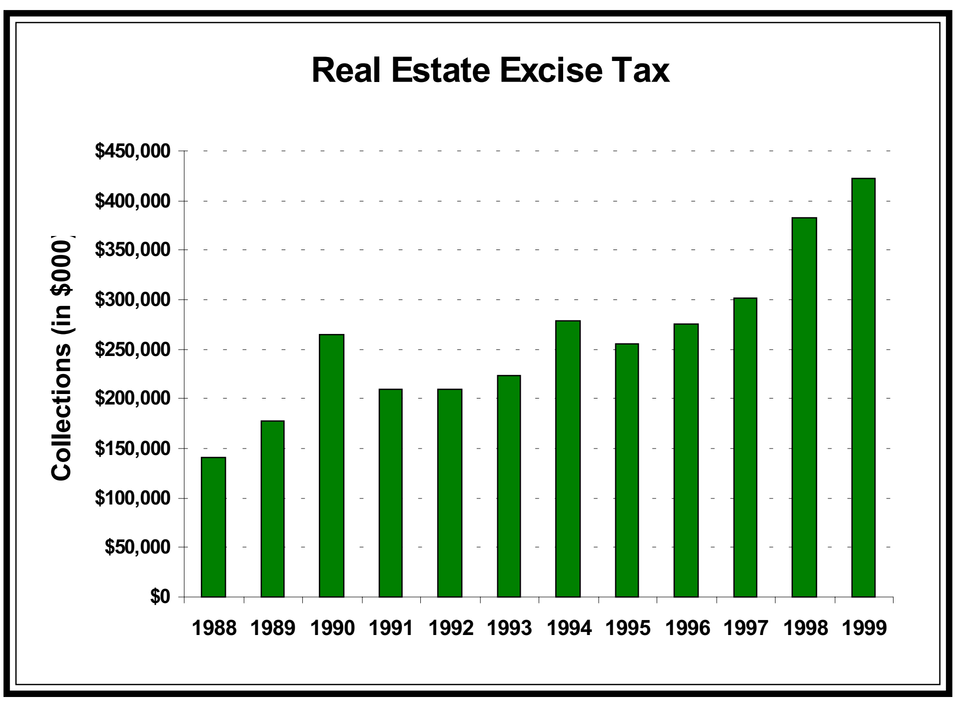
local options were authorized: Cities and counties were allowed to levy an additional 0.25 percent to fund capital projects associated with growth management and counties were given the option to levy an additional 1.00 percent to purchase and maintain conservation areas. With these options, the total local REET allowed has grown to 2.00 percent, bringing the maximum combined state and local real estate excise tax rate in Washington to 3.28 percent. Most jurisdictions impose a combined rate of either 1.53 percent or 1.78 percent, according to the state Department of Revenue.

County treasurers collect the real estate excise tax for the state. In return, counties keep one percent of the collections for administrative purposes. Of the net proceeds to the state, 7.7 percent goes into the Public Works Assistance Account, which helps local governments pay for public infrastructure and facilities. The remaining 92.3 percent goes into the state general fund (GFS) where it helps pay for education, social services, prisons, environmental programs, and other responsibilities of state government.

Robust Real Estate Market Produced Record Revenues

Revenue produced by the real estate excise tax was at an all-time high in 1999, accounting for about four percent of the GFS and generating $435 million. Although robust real estate market conditions have resulted in a general upward trend in REET collections over the last decade, they bounce around quite a bit and can be expected to fall off again when the economy cools. The accompanying figure shows REET collections climbing from a low of $141 million in 1988 to 1999's record high.



The base to which the real estate excise tax applies also varies among the states. Some states, like Washington, have a broad base, taxing the entire purchase price. Others tax only the buyer's equity. With its broad base and high rates, Washington's tax ranks among the highest in the country.

Collections Tough to Depend On

"The real estate excise tax has extreme ups and downs, which makes it a headache to forecast," says Chuck Gusak of the State's Office of the Forecast Council. As shown in the accompanying table, its collections can fluctuate in absolute terms, bringing in more revenue than expected in some years, and falling short in others. For this reason, it is poorly suited as a funding source for activities requiring steady, on-going expenditures.

Tax Harder On First-Time Homebuyers and Small Businesses

This tax has a greater impact on lower- and middle-income households. It is regressive, exacting proportionally more from lower than from higher income households. Most first-time homebuyers fall into this category, where the tax requires a larger share of their disposable income than it does of higher income purchasers. Similarly, small businesses struggle more than larger enterprises.

Market Determines Who Pays the REET

Who actually pays the REET has been a subject of debate over its history. All but one of the state and local options are paid directly from the seller's proceeds. Even so, during much of the last 20 years, markets have been active enough that most sellers have been able to add the amount of the REET to the selling price of their property. This effectively inflates a property's market value, requiring the buyer to pay thousands of dollars more than they might without the tax. Only in a sagging real estate market with slow sales activity can buyers begin to push the burden of this tax back on to sellers in the form of reduced sales prices. In this situation a small business, potentially struggling with going out of business, can be placed at a special disadvantage.

In 1990 when policy makers were looking for new sources of funds to help local governments pay for the requirements associated with the Growth Management Act, they wanted to place the cost of growth on newcomers to the state. The local 0.25 percent REET option passed that year requires sellers to pay for the second 0.25 percent. Legislative requirements, however, do little to avert the marketplace, which, in the end, will determine who pays.

Conclusion

Because of the volatility of the real estate excise tax, lawmakers should not rely on it to pay for ongoing government activities. At some point lawmakers may wish to consider reducing the real estate excise tax rate or exempting residential purchases falling below some specific value, as part of the state's strategy for addressing housing affordability.

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