

## WSR 21-10-023

## PROPOSED RULES

## DEPARTMENT OF REVENUE

[Filed April 26, 2021, 1:14 p.m.]

Original Notice.

Preproposal statement of inquiry was filed as WSR 21-03-054.

Title of Rule and Other Identifying Information: WAC 458-61A-1001  
Graduated real estate excise tax rates—Exceptions to graduated rates—  
Disregarded transactions.

Hearing Location(s): On June 8, 2021, at 10:00 a.m. This meeting  
will be conducted over the internet and telephone. Contact Keith Da-  
cus, management analyst, at KeithD@dor.wa.gov for login/dial-in infor-  
mation.

Date of Intended Adoption: June 22, 2021.

Submit Written Comments to: Brenton Madison, P.O. Box 47453,  
Olympia, WA 98504-7453, email BrentonM@dor.wa.gov, fax 360-534-1606,  
by June 11, 2021.

Assistance for Persons with Disabilities: Contact Julie King or  
Renee Cosare, phone 360-704-5733 or 360-704-5734, TTY 800-833-6384.

Purpose of the Proposal and Its Anticipated Effects, Including  
Any Changes in Existing Rules: This new rule will explain the real es-  
tate excise tax graduated rates provided in RCW 82.45.060, as well as  
explain the exceptions to the application of graduated tax rates,  
which are covered in RCW 82.45.060(3). The rule will also explain cir-  
cumstances under which the department will disregard the form of a  
transaction per RCW 82.45.235.

Reasons Supporting Proposal: Provides taxpayers the guidance re-  
garding the real estate excise tax in light of the passage of ESSB  
5998 (2019).

Statutory Authority for Adoption: RCW 82.01.060, 82.45.060, and  
82.45.235.

Statute Being Implemented: RCW 82.45.060 and 82.45.235.

Rule is not necessitated by federal law, federal or state court  
decision.

Agency Comments or Recommendations, if any, as to Statutory Lan-  
guage, Implementation, Enforcement, and Fiscal Matters: None.

Name of Proponent: Department of revenue, governmental.

Name of Agency Personnel Responsible for Drafting: Brenton Madi-  
son, 6400 Linderson Way S.W., Tumwater, WA, 360-534-1583; Implementa-  
tion and Enforcement: John Ryser, 6400 Linderson Way S.W., Tumwater,  
WA, 360-534-1605.

A school district fiscal impact statement is not required under  
RCW 28A.305.135.

A cost-benefit analysis is not required under RCW 34.05.328. This  
rule is not a significant legislative rule as defined by RCW  
34.05.328.

The proposed rule does not impose more-than-minor costs on busi-  
nesses. Following is a summary of the agency's analysis showing how  
costs were calculated. The proposed rule does not impose more-than-mi-  
nor costs on businesses, as it does not propose any new requirements  
not already provided for in statute. The proposed rule does not impose  
fees, filing requirements, or recordkeeping requirements that are not  
already established in statute.

April 26, 2021  
Atif Aziz  
Rules Coordinator

OTS-2852.2

NEW SECTION

**WAC 458-61A-1001 Graduated real estate excise tax rates—Exceptions to graduated rates—Tax avoidance arrangements.** (1) **Introduction.** This rule explains how the graduated real estate excise tax rates apply to transactions subject to real estate excise tax (REET). See chapter 82.45 RCW. The rule also explains when and how the tax rates change over time. In addition to the REET discussed in this rule, a sale of real property may also be subject to an excise tax imposed by a county or city. See RCW 82.46.010.

(2) **Other rules that may apply.** Readers may want to refer to other rules for additional information, including:

(a) WAC 458-30-200 Definitions.

(b) WAC 458-61A-100 Real estate excise tax—Overview.

(c) WAC 458-61A-101 Taxability of the transfer or acquisition of the controlling interest of an entity with an interest in real property located in this state.

(d) WAC 458-61A-102 Definitions.

(e) WAC 458-61A-301 Payment of tax, collection responsibility, audit responsibility, and tax rulings.

(f) WAC 458-61A-303 Affidavit.

(g) WAC 458-61A-306 Date of sale, interest, and penalties.

(3) **Examples.** This rule includes examples that identify a number of facts and then state a conclusion. These examples should only be used as a general guide. The tax results of other situations must be determined after a review of all the facts and circumstances.

(4) **Definitions.** In addition to the definitions found in chapter 82.45 RCW, the following definitions apply throughout this section.

(a) **"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 affixed to the land. Affixed structures may include fences, irrigation systems, machinery, or other types of property, dependent upon the determinative factors under Washington law:

(i) Actual annexation of the realty, or something appurtenant thereto;

(ii) Application to the use or purpose to which that part of the realty with which it is connected is appropriated; and

(iii) The intention of the party making the annexation to make a permanent accession to the freehold. See *Dep't of Revenue v. Boeing*, 85 Wn.2d 663, 538 P.2d 505 (1975).

(b) **"Classified land"** refers to land falling under this rule's definitions for "agricultural land" or "timberland."

(c) **"Consumer price index for shelter"** means the most current seasonally adjusted index for the shelter expenditure category of the consumer price index for all urban consumers (CPI-U) as published by July 31st of each year by the United States Department of Labor, Bureau of Labor Statistics.

(d) **"Growth of the consumer price index for shelter"** means the percentage increase in the consumer price index for shelter for the most recent three-year period for the selling prices threshold adjustment in 2022, and the most recent four-year period for the subsequent selling price threshold adjustments.

(e) **"Meaningful purpose"** means, apart from its tax benefits, a bona fide and significant reason for structuring a transaction in a certain way, such as a substantial increase in profit or reduction in cost.

(f) **"Nonclassified land"** refers to land that is not "classified land."

(g) **"Substantial nontax reason"** means a bona fide nontax reason that is a substantial motivating factor to the taxpayer's decision to enter into the arrangement or transaction in this state. A bona fide nontax reason may include the purpose of obtaining tax benefits from another government, provided the benefits are not the same type, kind, or nature of any substantial Washington state tax benefit obtained under the arrangement or transaction.

(h) **"Timberland"** means 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 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.

(5) **Graduated tax rates and thresholds.**

(a) For the period of January 1, 2020, through June 30, 2022, the selling price of a sale of real property, except as provided in subsection (7) of this rule, is subject to the real estate excise tax at the following tax rates (state portion only):

(i) 1.1 percent of the portion of selling price less than or equal to \$500,000;

(ii) 1.28 percent of the portion of the selling price greater than \$500,000 and less than or equal to \$1,500,000;

(iii) 2.75 percent of the portion of the selling price greater than \$1,500,000 and less than or equal to \$3,000,000; and

(iv) 3 percent of the portion of the selling price greater than \$3,000,000.

(b) Effective July 1, 2022, and every fourth year thereafter, the tax rate thresholds increase by the same percentage as the growth of the "consumer price index for shelter," but not more than 5 percent.

(6) **Determining the proper tax rate(s).**

(a) **Deeded transfers.** Graduated tax rates are determined according to the total selling price of a sale of real property. "Selling price" means the true and fair value of the property conveyed, which is presumed to be the total consideration paid to the transferor in an arm's length transaction between unrelated persons for a valuable consideration. See WAC 458-61A-102. Real property conveyed in an arm's length transaction between unrelated persons for a valuable consideration may include more than one parcel of real property. See RCW 82.45.030(1).

In cases where a sale includes parcels of real property located in more than one county, a separate real estate excise tax affidavit must be filed with each county, however, the selling price for purposes of the graduated tax rates is unaffected. For more information on completing affidavits see WAC 458-61A-303.

**Example 1. Single arm's length transaction.**

**Facts:** Sam Moore has owned three separate but adjacent retail parcels located in Thurston County for several years. Mr. Moore decides to sell all three of the parcels, which share a parking lot, and lists/markets the properties as a single sale. Mr. Moore agrees to sell the properties to Michelle Smith. The sale occurs on June 1, 2020, with a total selling price of \$1,000,000 for the three parcels of real property. Individually each property is valued by the Thurston County assessor at \$250,000, \$275,000, and \$375,000 respectively.

**Result:** The total selling price for determining the applicable tax rate is \$1,000,000.

**Example 2. Separate arm's length transactions.**

**Facts:** Assume the facts from example 1, except that Mr. Moore separately markets and lists each parcel of real property for sale. During the month of June 2020, Mr. Moore receives three separate offers for each parcel of real property, which he accepts. The purchaser of each property is a separate unrelated party. Mr. Moore is unrelated to each of the buyers and each of the sales are completed at arm's length. The selling price of each parcel of real property is \$300,000, \$300,000, and \$400,000.

**Result:** Mr. Moore made three separate sales of real property. The REET rate applicable to each sale is determined by the selling price of each parcel of real property.

**Example 3. Single arm's length transaction (property located in multiple counties).**

**Facts:** Anna Carter owns and leases two buildings to the same lessee, which the lessee uses to operate his nail salon businesses located in Yelm, Washington and Roy, Washington. Rather than list the properties for sale with an agent, Ms. Carter decides to sell both properties to the lessee, James Wright. The sale occurs on August 1, 2020, and the selling price is \$900,000.

**Result:** For purposes of determining the applicable tax rate, Ms. Carter must use the total selling price of \$900,000 when applying the tax rate thresholds. Because the sale involves real property parcels located in multiple counties, a separate affidavit must be filed with each county.

(b) **Controlling interest transfers.** For purposes of determining the applicable real estate excise tax rate(s), the selling price means the true and fair value of the real property owned by the entity at the time the controlling interest is transferred. See WAC 458-61A-101(4) for more information on the measure of tax for controlling interest transfers.

(7) **Sales of real property classified as agricultural land or timberland.** The sale of real property classified as either "agricultural land" or "timberland," is subject to a nongraduated REET rate of 1.28 percent. In instances where a sale includes both "agricultural land" or "timberland" and nonclassified land, the predominant use of the real property determines the applicable tax rate. RCW 82.45.060.

(a) **Predominant use factors.** Predominant use is determined by two equal factors:

- (i) Square footage factor; and
- (ii) County-assessed value factor (value factor).

(b) **Predominant use calculation.** Real property is predominantly used as classified land if the classified portion of the property accounts for at least 50 percent of the average of the square footage and county-assessed value. The determination is computed as follows:

(i) Divide the square footage of classified land by the square footage of all real property included in the sale.

(ii) Divide the county-assessed value of classified land by the county-assessed value of all real property included in the sale.

(iii) Add the calculated value in (b)(i) of this subsection to the calculated value in (b)(ii) of this subsection, then divide the sum by two.

(iv) If the result is equal to or greater than 0.5, all of the real property included in the sale is treated as classified land subject to the flat rate of 1.28 percent. If the result is less than 0.5, all of the real property included in the sale is treated as nonclassified land subject to the graduated tax rates.

(c) **Land classification based on continued land use.** For purposes of Title 84 RCW, Property taxes, 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 treat the real property as agricultural land or timberland for purposes of determining the predominant use of real property included in the sale.

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 nonclassified land for purposes of determining its predominant use for REET purposes.

Real property is only treated as classified land if:

(i) The buyer indicates it will continue to use the land in a qualifying manner; and

(ii) The county assessor approves the land for such continued use.

(iii) If the conditions in (c)(i) and (ii) of this subsection are not met, the seller must report the real property as nonclassified land for purposes of determining the applicable tax rate.

**Example 4. Real property sale involving classified and nonclassified land - Predominantly classified land.**

**Facts:** A real property sale of 2 parcels of real property, Parcel A and Parcel B. The selling price is \$1,500,000. Parcel A is classified land (agricultural land) and Parcel B is nonclassified land. Parcel A is 3,600,000 square feet. Parcel B is 400,000 square feet. The county assessed value of Parcel A is \$150,000. The county assessed value of Parcel B is \$1,100,000. The real property's predominant use is determined as follows:

1. Square footage factor:  $0.90$  ( $3,600,000$  sq. ft. (classified land) /  $4,000,000$  sq. ft. (total square footage of Parcel A and Parcel B)).

2. Value factor:  $0.12$  ( $\$150,000$  (county-assessed value of Parcel A) /  $\$1,250,000$  (county-assessed value of Parcels A and B)).

3. **Predominant use determination:**  $0.51$  ( $(0.90 + 0.12) / 2$ ).

**Result:** The predominant use of the property sold is for a classified purpose. If the buyer intends to continue using the land in a qualifying manner and the county assessor approves the real property for continued designation as classified land, the sale is subject to a flat tax rate of 1.28 percent. The tax liability is \$25,600.

(8) **Disregarding the form of certain arrangements designed to avoid tax.** RCW 82.45.235 authorizes the department to disregard the form of a transaction or series of transactions to determine the proper REET treatment based on the substance of the transaction or transactions. Among other actions, the department may treat a single sale as multiple sales or treat multiple sales as a single sale.

(a) Factors for disregarding the form of a transaction(s). When necessary to deny the tax benefit that would otherwise accrue from engaging in one or more related transactions designed to avoid tax under this chapter, the department is authorized to disregard the form of the transaction or series of transactions and determine the proper tax treatment based on the substance of the transaction or transactions. In exercising this authority, the department may consider the factors described in RCW 82.32.655 (2) (a), (b), (c), and (f):

(i) Whether an arrangement or transaction changes in a meaningful way, apart from its tax effects, the economic positions of the participants when the transaction is considered as a whole;

(ii) Whether substantial nontax reasons exist for entering into a transaction;

(iii) Whether a transaction is a reasonable means of accomplishing a substantial nontax purpose; and

(iv) Other relevant factors.

(b) **Result of a disregarded transaction(s).** For transactions occurring on or after January 1, 2020, in cases where the department disregards the form of a transaction(s), the department will determine the amount of tax properly due based on the actual substance of the transaction(s). See WAC 458-61A-306(6) and 458-20-228 (5)(f) for information on instances where the department may apply an evasion penalty if a tax deficiency results from an intent to evade tax.

**Example 5. Tax avoidance - Series of sales of a partial interest in a single parcel of real property.**

**Facts:** In February 2020, Prime Office Inc. (Prime) agrees to buy a large office building in Seattle for \$3,500,000 from King Commercial Inc. (King). In order to pay the lowest rate of tax, the parties agree to structure the sale as seven separate sales of a one-seventh interest in the parcel of real property, each with a selling price of \$500,000 ( $1/7 \times \$3,500,000$ ). The sales are completed and recorded during the month of February 2020. As a result of the arrangement, the total real estate excise tax paid on the transactions is \$38,500 ( $1.1\%$  tax rate  $\times$  \$3,500,000).

**Result:** The department will disregard the reported form of the separate transactions and treat the arrangement as a single sale, with a selling price of \$3,500,000. As a result, the proper amount of tax due for the transaction is \$74,550. The department will assess \$36,050 in additional real estate excise tax.

**Example 6. Tax avoidance - Multiple owners of a single real property parcel - Individual interests sold separately.**

**Facts:** Juan and Li are business partners who each own a 50 percent interest in an LLC that owns one residential property in Washington. Juan and Li agree to sell the residential property to an unrelated third party, Mike, for \$1,000,000. In order to reduce the amount of real estate excise tax due on the transaction, prior to completing the sale, Juan and Li each redeem their 50 percent interest in the LLC for a 50 percent interest in the real property held by the LLC. Afterwards, each party separately conveys their fifty percent interest in the property as separate sales to Mike. Juan and Li complete separate REET affidavits for these transactions. As a result of the arrange-

ment, the total real estate excise tax paid on the transactions is \$11,000 ((1.1% tax rate x \$500,000 selling price) + (1.1% tax rate x \$500,000 selling price)).

**Result:** The department will disregard the reported form of the separate transactions and treat the arrangement as a single sale, with a selling price of \$1,000,000. As a result, the proper amount of tax due for the transaction is \$11,900. The department will assess \$900 in additional real estate excise tax.

**Example 7. Tax avoidance - Sale of adjacent real property parcels separately.**

**Facts:** Wei owns two adjacent parcels of real property in Kennebec, a retail shopping plaza and an adjacent parking lot used by patrons of the shopping plaza. Wei advertises the sale of both parcels for a single price of \$1,920,000. Wei sells both parcels to Hui on June 15, 2020. Instead of completing a single real estate excise tax affidavit to include both parcels in the reported sale, Wei completes separate affidavits for each parcel, disclosing a selling price of \$1,450,000 for the retail shopping plaza and \$470,000 for the adjacent parking lot. As a result of the arrangement, the total real estate excise tax paid on the transactions is \$22,830 (\$17,660 for the retail shopping plaza and \$5,170 for the parking lot).

**Result:** The department will disregard the form of the separate transactions and treat the arrangement as a single sale, with a selling price of \$1,920,000. As a result, the proper amount of tax due for the transaction is \$29,850. The department will assess \$7,020 in additional real estate excise tax.

**Example 8. Tax avoidance - Real property sale involving classified and nonclassified land.**

**Facts:** Janice is selling 2 parcels of real property, Parcel A and Parcel B, to Samuel. The selling price is \$5,000,000. Parcel A is classified land (agricultural land that is approved by the County Assessor for continued use by Samuel) and Parcel B is nonclassified land. Parcel A is 1,500,000 square feet. Parcel B is 500,000 square feet. The county assessed value of Parcel A is \$900,000. The county assessed value of Parcel B is \$3,600,000. The predominant use factors, discussed in subsection (7)(a) of this rule, for Parcels A and B are computed as follows:

- Square footage factor: 0.75 (1,500,000 sq. ft./2,000,000 sq. ft.);
- Value factor: 0.20 (\$900,000/\$4,500,000).

Adding the two factors and dividing by two yields 0.475 ((0.80 + 0.16)/2). Because this result is less than 0.5, a combined sale of Parcels A and B would be treated as nonclassified land subject to the graduated tax rates.

After determining that the combined sale of Parcels A and B would be subject to graduated tax rates and a total tax liability of \$119,550, Janice and Samuel agree to restructure the transaction as two separate sales. Parcel A is sold for \$1,000,000 and Parcel B is sold for \$4,000,000, resulting in a REET liability of \$102,350.

**Result:** Based on the intent of the parties to restructure the transaction as two separate transactions to avoid tax, the department will disregard the form of the reported sales and treat the sales as a single transaction.

**Example 9. Tax avoidance - Real property sale involving classified and nonclassified land.**

**Facts:** Property, Inc. is selling property used as a motor vehicle sales and service center, located in Seattle, WA (Property A). The

area of Property A is 130,680 square feet, and its selling price is \$23,500,000. Property, Inc. is separately selling a 297 acre parcel (12,937,320 square feet) of agricultural land located in Lincoln County (Property B). The selling price of Property B is \$300,000.

Auto Dealer agrees to purchase Property A, which it will use to operate an auto dealership in Seattle. Property, Inc. and Auto Dealer also agree to include Property B in the sale (approved for continued use as classified land by the County Assessor). Auto Dealer is not capable of using the classified land as agricultural land. The agreement between Property, Inc. and Auto Dealer requires Property, Inc. to assist Auto Dealer in reselling Property B and cover certain selling expenses.

At the time of completing the sale, Property, Inc. completes REET affidavits reporting a combined sale of both properties subject to a flat REET rate of 1.28 percent for the entire transaction, and a total liability of \$304,640 in state REET. Had Property A and Property B been sold separately, the total REET on the transactions would have been \$678,390, a difference of \$373,750. Thus, the potential tax savings exceeded the price of including Property B in the sale.

The parties do not provide a substantial nontax reason for arranging the sale of both properties as a single transaction.

**Result:** The circumstances indicate the transaction was designed to avoid tax. Therefore, the department will disregard the form and treat the transaction as two separate sales.

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