

## POLICY NOTE

# Washington state's land use regulations need an overhaul: real estate policies leave little room for autonomy

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### Key Findings

1. The unique circumstances of some agricultural land and timberland sales make them potentially subject to regular real estate tax transactions, despite supposed protections in place.
2. When sorting through tax policies, concerns for personal autonomy should be at the forefront and the rights of the landowner should be considered as a critical guiding factor in how tax rates are applied.
3. The current Real Estate Excise Tax (REET) rate for qualifying agricultural land and timberland is 1.28 percent.
4. The subjective nature of "highest and best use" should be replaced with an objective structure that allows landowners to define their own land-use needs.
5. The political chess that goes into land use and real estate taxation decisions throughout our state restricts the freedom to do as one chooses with one's own land.
6. Washington state would benefit greatly from allowing landowners to do as they wish with their land with minimal arbitrary interference from state regulators.

### Introduction

Artist Andy Warhol said, "I think having land and not ruining it is the most beautiful art that anybody could ever want to own." While the ultra-urban pop artist was as far from being a farmer as one could be, his words nevertheless ring true in agriculture. Land, and particularly the ability to use it for the cultivation of crops or raising livestock, is protected both by a legal land designation and by a partial tax credit in Washington state.

Both of these regulatory structures, on the surface, are intended to ensure farmland serves the public interest by being retained for the primary function of food production. The Open Space Taxation Act, enacted in 1970, allows landowners to have their "open space, farm and agricultural, and timber lands valued at their current use rather than their [theoretical] highest and best use" in an effort to preserve those spaces for the benefit of our state. The partial agricultural exemption within the real estate excise tax (REET) provides a similar public function – offering an incentive for keeping farmland in food production activity to help provide for basic human needs.

While both policies are critical drivers for keeping agriculture as a major contributor to Washington state's economy, even in difficult times, there are some problems with the application of both when looking at the diversity of agriculture statewide. King, Pierce, and Snohomish counties have unique problems that are not helped by the penalties of the agricultural exemption built into the REET, while vague phrases like "highest and best use" are subjective in nature and application. When sorting through tax policies, concerns for personal autonomy should be at the forefront and the rights of the landowner should be considered as a critical guiding factor in how tax rates are applied.

### The Real Estate Excise Tax (REET)

During the 2019 legislative session, ESSB 5998 passed the legislature and was signed into law which created the graduated real estate excise tax.<sup>1</sup> In January 2020, the change in how sales tax is calculated on real estate transactions went into effect. The new graduated rate structure collects taxes at rates ranging from 1.10 to 3 percent based upon the total

<sup>1</sup> Engrossed Substitute Senate Bill 5998: relating to a graduated real estate excise tax. State of Washington. 66th Legislature. 2019 Regular Session. Accessed Feb. 3, 2021. <http://lawfilesexternal.wa.gov/biennium/2019-20/Pdf/Bills/Senate%20Bills/5998-S.E.pdf?q=20210203165824>.

sale price.<sup>2</sup> Agricultural land and timberland are exempt from the graduated rate structure. Instead, buyers of these properties pay a flat tax rate of 1.28 percent. In addition to the flat-rate structure, both agricultural land and timberland are potentially subject to higher tax rates when they are sold as part of multi-parcel transactions.

In the case of single-parcel land sales, the REET is determined by the classification in the county where the parcel is located and whether that land is continuing in the same classification post-sale. If both of those standards are met, the buyer in a single-parcel sale meets the REET criteria for paying the 1.28 percent tax rate.

Multiple parcel land sales are more complicated and require consideration of several factors when determining whether the agricultural REET rate applies. If the sale includes several parcels – some that are classified as agricultural land or timberland and some that are not – then a formula for determining which tax rate applies must be followed:

1. Divide the square footage of the agricultural land or timberland by the square footage of all the land included in the sale.
2. Divide the county assessed current value of the agricultural land or timberland by the county assessed current use value of all land included in the sale.
3. Add the result from Step 1 to the result from Step 2, then divide by two.
  - a. If the result is equal to or greater than 0.5, all of the land is predominantly agricultural land or timberland and is subject to the 1.28 percent flat REET rate.
  - b. If the result is less than 0.5, all the land included in the sale is “non-classified” and is subject to the graduated REET rate scale.<sup>3</sup>

This complex structure means there are times when the agricultural land and timberland flat rate does not apply to those lands and a higher tax rate is imposed. The unique circumstances of some agricultural land and timberland sales make them potentially subject to regular real estate tax transactions, despite the supposed protections in place to avoid those circumstances.

## Wide open spaces

The natural majesty of our state can be found in its open spaces. Whether it is in the wild timber of Western Washington, the tidy rows of wine grapes in Walla Walla, or the green pastures hidden in the Okanogan Highlands, each area offers a unique experience for landowners and passersby alike. Many of those open areas are protected by the Open Space Taxation Act<sup>4</sup> which protects open space,

<sup>2</sup> “Special Notice: New Graduated Real Estate Excise Tax (REET).” Washington State Department of Revenue. Published Dec. 16, 2019. Accessed Sept. 29, 2020. [https://dor.wa.gov/sites/default/files/legacy/Docs/Pubs/SpecialNotices/2019/sn\\_19\\_NewGradREET.pdf](https://dor.wa.gov/sites/default/files/legacy/Docs/Pubs/SpecialNotices/2019/sn_19_NewGradREET.pdf)

<sup>3</sup> “Special Notice: New Graduated Real Estate Excise Tax (REET).” Washington State Department of Revenue. Published Dec. 16, 2019. Accessed Sept. 29, 2020. [https://dor.wa.gov/sites/default/files/legacy/Docs/Pubs/SpecialNotices/2019/sn\\_19\\_NewGradREET.pdf](https://dor.wa.gov/sites/default/files/legacy/Docs/Pubs/SpecialNotices/2019/sn_19_NewGradREET.pdf)

<sup>4</sup> “Open Space Taxation Act.” Washington State Department of Revenue. Published July 2017. Accessed Sept. 29, 2020. [https://dor.wa.gov/sites/default/files/legacy/Docs/Pubs/Prop\\_Tax/OpenSpace.pdf](https://dor.wa.gov/sites/default/files/legacy/Docs/Pubs/Prop_Tax/OpenSpace.pdf)

agricultural and farm, and timber lands from being taxed based upon what they could be used for rather than what they are used for.

Landowners can apply to have their land given an open space designation at the county level. If land qualifies as open space, it remains in that status until an additional petition is filed to remove the status. Any taxes assessed on the land are collected by the county as well.

If land with an open space designation is sold for purposes other than farming, then the land is subject to a compensating tax. The compensating tax is the assessed difference between the current market value and the current use value back seven years plus an interest charge of one percent per month plus a 20 percent penalty. In essence, it is the amount of taxes that would have been paid on the land if it had not been placed in the open space designation. If land has been in the open space designation for more than 10 years, the 20 percent penalty is waived.

By employing the open space designation, landowners avoid the arbitrary nature of the application of “highest and best use” determinations.

The built-in buyer’s penalty should discourage the sale of farm property for non-agricultural pursuits on lands designated for agriculture. However, despite the seller’s penalties and open space protections available, Washington State still lost 68,250 acres of farmland between 2012 and 2017.<sup>5</sup> The loss is the equivalent to 1,456 farms with an average acreage of 46.8 acres per farm, which is statistically on pace for the largest farm size category in our state, farms sized 10 to 49 acres.

The acreage loss despite the open space protection can be attributed to farmers in Washington state retiring with no one to replace them on the farm. The average age of “all principle operators” in our state is 59.<sup>6</sup> The physical demands of agricultural work become difficult to answer day after day and many producers opt for retirement or an ag-adjacent profession – seed sales, farm manager, or equipment sales – rather than the daily grind of farming itself. Part of that exit process is the sale of farmland. The average per-acre sale price of farmland in Washington state is \$13,000 an acre,<sup>7</sup> a slight decline from previous years. For some farmers, agricultural land in developing areas acts as a retirement fund.

While food security through local production is an important benefit of the open space designation, landowners should not be punished for aging out of their profession and retiring with no one to take over their operations. If lawmakers want to ensure farmland remains in food production, an incentive for retiring farmers to offer a long-term buyout solution to younger farmers makes more sense than imposing punitive actions for land sales to developers.

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5 “Table 9. Land in Farms, Harvest Cropland, and Irrigated Land by Size of Farm: 2017 and 2012.” U.S. Department of Agriculture. Published 2018. Accessed Sept. 29, 2020. [https://www.nass.usda.gov/Publications/AgCensus/2017/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Washington/st53\\_1\\_0009\\_0010.pdf](https://www.nass.usda.gov/Publications/AgCensus/2017/Full_Report/Volume_1,_Chapter_1_State_Level/Washington/st53_1_0009_0010.pdf).

6 “Table 52. Selected Producer Characteristics: 2017 and 2012.” U.S. Department of Agriculture. Published 2018. Accessed Sept. 29, 2020. [https://www.nass.usda.gov/Publications/AgCensus/2017/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Washington/st53\\_1\\_0052\\_0052.pdf](https://www.nass.usda.gov/Publications/AgCensus/2017/Full_Report/Volume_1,_Chapter_1_State_Level/Washington/st53_1_0052_0052.pdf).

7 “Report: State’s farmland value dips over previous year.” Tri-Cities Area Journal of Business. Published February 2019. Accessed Sept. 29, 2020. <https://www.tricitiesbusinessnews.com/2019/02/washington-farmland/?cn-reloaded=1>.



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## “Highest and best use”

In our state’s tax structure regarding real estate, the phrase “highest and best use” is applied to determine the tax rate for all property. However, the definition of “highest and best use” is up to interpretation by county assessors who must consider “the most profitable, likely use of the property.”<sup>8</sup> The application of “highest and best use” leaves no room for individual landowners to make a determination about how they want to use their own property if it is outside the scope of open space protection.

Rather than imposing a subjective determination upon land use in Washington and being at the mercy of the need for open space protection, landowners should be provided with a structure that allows them to define their own use needs. If a farmer chooses to use all of his or her owned property for food production or chooses to convert a portion of his or her farm into a dancehall to earn off-season income, the choice should be left to him or her.

## Politics and land use

Landowners have limited options for the use of their own property. Farmers have to apply for an open space designation to protect their land from excessive taxation but once they have entered that system, their land is devalued by back taxes if they choose to sell it. The political chess that goes into land use decisions throughout our state restricts the freedom to do as one chooses with one’s own land.

Land use restrictions must be applied in a “statewide manner” by the legislature to supersede the supremacy of county jurisdictions.<sup>9</sup> In practical application, given the unique and varied landscapes of our state, policies enacted by lawmakers often have the consequence of negatively affecting farms and ranch lands. A blanket land use policy does no favors for any landowner across the state. The same blanket land use policy, however, allows lawmakers to continue to impose their will upon individuals statewide.

## Conclusion

Stewardship and ownership of land in Washington state is an opportunity not afforded to everyone because the cost of land is high and the tax burden potentially higher at the point of a land sale. However, much of the tax code related to real estate and applied to agricultural lands is subjective.

The partial tax credit afforded to farmers and ranchers through the REET and the open space designation does not counteract the punitive tax rates assessed when land is sold for a non-agricultural use. The political will and subjective nature of “highest and best use” assessments make landownership unnecessarily complex. The state would benefit greatly from allowing landowners to do as they wish with their land with minimal arbitrary interference from state regulators.

<sup>8</sup> Washington Administrative Code 458-07-030. Effective March 1, 2009. Accessed Dec. 3, 2020. <https://apps.leg.wa.gov/wac/default.aspx?cite=458-07-030>

<sup>9</sup> Washington State Attorney General’s Office. “Authority of County to Require Federal and State Agencies to Follow County Policies and Procedures.” July 29, 1994. Accessed Dec. 3, 2020. <https://www.atg.wa.gov/ago-opinions/authority-county-require-federal-and-state-agencies-follow-county-policies-and>