

Is out-of-state property subject to Washington estate tax?

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Washington is one of only a few states in the country that has its own estate tax. This is in addition to the federal estate tax and it applies not only to property located in Washington – but property outside the state as well. This article will answer questions about what assets owned by Washington state residents are subject to Washington estate tax.

Many Washingtonians assume that only their Washington-sited property is subject to Washington estate tax and that their non-Washington-sited property escapes this tax. While only Washington state property is subject to Washington estate tax, out-of-state property can increase the state estate tax rate.

It's important to understand the two areas that will impact how Washington estate tax applies to property located outside the state. The first is what types of assets are considered “sourced” or “sited” in Washington. The second is what effect non-Washington property has on the Washington taxable estate.

Determining the Character and Legal Location of Property

Assets that have a tangible quality to them, such as real property or personal property, are generally sited to their physical location. Most assets are obvious as to whether they are physically located outside Washington. For example, real property - i.e., land - is quite observably located inside or outside the state. Other personal assets, or tangible personal property, such as cars, jewelry, and artwork, are likewise observably located outside or inside the state. If real property or tangible personal property is located outside Washington, it is considered to be sited outside of Washington if owned directly or through a revocable trust.

Understanding intangible personal property is a little trickier than understanding real property or tangible personal property. Intangible personal properties are those unobservable assets such as bank and investment accounts, bonds, notes, entity interests, and retirement plans consisting of “rights and privileges having a legal but not a physical existence.” Items of intangible personal property are deemed to be Washington-sited property with respect to Washington residents, even if the actual underlying property is located out-of-state. This is because the individual owns the intangible interest rather than the underlying physical property, and the intangible interest, like a shadow, “follows” and takes up residence with the owner in his or her jurisdiction.

For example, a Washington resident may own land in Oregon (a) in his or her individual capacity, (b) as the grantor of a revocable trust to which the land is transferred, or (c) by indirect ownership in an Oregon entity such as a partnership. In this example, the land is considered to be sited in Oregon in only the first two scenarios. By contributing the land to a partnership, the owner converted that land into an intangible asset; he or she no longer owns the land itself directly, but instead owns the partnership interest. The partnership interest, which includes the value of the Oregon land, is itself considered to be sited in Washington. The entity interest

follows the individual owner, and for legal purposes the location of the property is where the owner resides.

As can be seen in the above example, the ownership structure is key to the legal location of the asset. Assets that are physically located outside of Washington are deemed to be sited outside of Washington only if they are held directly by the individual or through a revocable trust.

Application of Washington Estate Tax

For Washington residents, owning assets sited outside of Washington actually serves to increase their Washington estate tax rate. Here is the rub. Washington ignores the location of assets in the preliminary steps of determining the appropriate estate tax rate. It instead includes all property, including the out-of-state property, when determining the value of the Washington gross estate. Then, any applicable deductions are applied to the value of a Washington estate, which is taxed on assets greater than \$2,193,000. Out-of-state assets are then deducted from the gross estate, leaving the remaining amount in the Washington taxable estate. This is the figure that sets the Washington estate tax rate. Then, by applying the estate tax rate to the value of the taxable estate, the amount of Washington estate tax due can be calculated.

Keep in mind that up to this point in calculating the Washington estate tax rate, non-Washington property is still included in all of these calculations. Only after the Washington estate tax amount is calculated using the applicable rate do we begin to look at the location of the assets of the taxable estate. Specifically, the amount of estate tax due is apportioned between the Washington property and any non-Washington property on a pro rata basis based on their relative values. Washington estate taxes are owed only on Washington property.

For example, consider Alex, a Washington resident who at death owned \$2 million in Washington real property and \$10 million in Arizona property. For simplicity, let's assume that no deductions other than the applicable exclusion amount of \$2,193,000 are available. Once the applicable exclusion amount is deducted, Alex's Washington taxable estate is \$9,807,000, setting the estate tax at the highest rate of 20%, or \$2,090,000. This amount is then apportioned between the Washington and Arizona property, and one-sixth, or \$348,333, of the estate tax is apportioned to the Washington property. This is the amount that Alex's estate owes to the Washington Department of Revenue. If Alex owned only \$2 million in Washington real property, no Washington estate tax would be owed because the exclusion amount is more than \$2 million.

In sum, due to the sliding estate tax rates (from 10% to 20%) the Washington estate tax rate can be higher than anticipated for Washington residents who have non-Washington assets because all assets are considered in order to establish the Washington estate tax rate.

Conclusion

Washington residents who own real estate or tangible personal property outside of Washington should be intentional in how they hold that property, as the type of ownership structure will determine the property's legal location. An attorney can help assess the benefits of the various

forms of property ownership and how they will impact Washington estate tax liability to determine the best ownership structure to meet individual goals.

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