

MINNESOTA • REVENUE

ESTATE TAX Differing QTIP Elections

April 17, 2006

Department of Revenue
Analysis of H.F. 4095 (Abrams) / S.F. 3736 (Rest)

	Yes	No
DOR Administrative Costs/Savings		X

Fund Impact

	<u>F.Y. 2006</u>	<u>F.Y. 2007</u>	<u>F.Y. 2008</u>	<u>F.Y. 2009</u>
			(000's)	
General Fund	\$0	(\$3,700)	(\$4,700)	(\$4,500)

Effective for estates of decedents dying after December 31, 2005.

EXPLANATION OF THE BILL

Current Law: The Minnesota estate tax statutes are based on federal estate tax statutes as contained in the Internal Revenue Code. In 2001, Congress increased the exclusion amounts for years of death 2002 through 2009 applicable to federal estate tax. Minnesota did not increase the exclusion amounts applicable to Minnesota estate tax. Rather, the lower Minnesota exclusion amounts for those same years of death continue to be based on federal law prior to the 2001 federal changes. Also, current Minnesota law has no provision that, upon the death of the first spouse of a married couple, allows the executor of an estate to make a qualified terminable interest property (QTIP) election for Minnesota purposes that is different from the QTIP election made for federal purposes. The QTIP election made for federal purposes must be used for the Minnesota estate tax as well. This becomes an estate tax planning issue because it is a common practice for the executor of an estate to make a QTIP election equal to the amount of the taxable estate over the federal exclusion amount. This eliminates the federal estate tax but, because Minnesota's exclusion amounts are lower than the federal exclusion amounts, results in an estate tax being owed to Minnesota.

Proposed Law: The executor of the decedent's estate would be permitted to make a QTIP election for Minnesota estate tax purposes that is different from the QTIP election made for federal estate tax purposes. The election could not exceed the federal election by more than the difference between the applicable federal exclusion amount and the applicable Minnesota exclusion amount. The property must meet the definition of qualified terminable interest property as defined in section 2056(b) (7) of the Internal Revenue Code. The Minnesota estate tax would be based on this alternative state QTIP election which would be made on the Minnesota estate tax return. Once made, the election would be irrevocable.

REVENUE ANALYSIS DETAIL

- The Minnesota exclusion amount was decoupled from the federal exclusion amount in 2002. For 2002 and 2003, the federal exclusion was \$1,000,000 and the state exclusion was \$700,000. For 2004, the federal exclusion was \$1,500,000 and the state exclusion was \$850,000. For 2005, the federal exclusion was \$1,500,000 and the state exclusion was \$950,000.

REVENUE ANALYSIS DETAIL (Continued)

- Since decoupling, Minnesota estate tax returns have been filed where the tax owed to Minnesota was due to the difference between the federal and state exclusion amounts. Those tax amounts are \$33,200 for 2002 and 2003, the amount of tax due to Minnesota for returns showing a taxable estate of \$1,000,000, and \$64,400 for 2004 and 2005, the amount of tax due to Minnesota for returns showing a taxable estate of \$1,500,000.
- For decedents with 2002, 2003, 2004, or 2005 dates of deaths, there was an average of 46 estate tax returns filed showing a tax amount due of \$33,200 plus or minus \$10, or \$64,400 plus or minus \$10.
- The number of differing Minnesota QTIP elections was assumed to be 50 for each year during the forecast period.
- Under current law, in which the Minnesota exclusion is \$950,000 for 2005, and \$1,000,000 for 2006 and later, if the QTIP election is for the amount of the estate over and above the federal exclusion, then the Minnesota estate tax is as follows:
 - \$99,600 for deaths occurring in 2006, 2007, and 2008 based on a taxable estate = \$2,000,000
 - \$229,200 for deaths occurring in 2009 based on a taxable estate = \$3,500,000
- It is assumed that the returns will be filed nine months after the death of the deceased.
- Since some of the tax lost under the proposal could be recovered upon the death of the second spouse, probabilities of spousal death were estimated using the United States Life Tables, 2000. The ages of the spouses were assumed to be 76 years which is consistent with the ages of the decedents. Two-thirds of the spouses were assumed to be female.
- Approximate spousal death rates for each of the four years after the death of the first spouse are 4% per year for a female age 76 and 5% per year for a male age 76.
- Due to the uncertainty of how the estate of the second spouse will change over time, it was assumed that the amount of the Minnesota estate tax recovered upon the death of the second spouse was in proportion to the amount of the estate tax that would be lost under the proposal upon the death on the first spouse.
- Assuming a continuation of 50 differing QTIP elections per year, the impact on the general fund could be a negative \$9,000,000 in fiscal year 2010 because the federal exclusion rises to \$3,500,000 for 2009 decedents.

Number of Taxpayers: Based on recent averages, about 50 estates annually could be affected by the QTIP proposal.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/taxes/legal_policy