ESTATE TAX
Exclusion of Certain Farm and Small Business Property

April 16, 2007

	Yes	No
DOR Administrative Costs/Savings	X	

Revised Analysis

Department of Revenue
Analysis of H.F. 2235 (Juhnke)/ S.F. 2019 (Skoe), Analysis Revised for Additional Detail

	Fund Impact			
	F.Y. 2008	**F.Y. 2009**	**F.Y. 2010**	**F.Y. 2011**
		(000's)		
Qualified Farm Property	($1,700)	($2,300)	($2,400)	($2,500)
Qualified Small Business Property	($800)	($1,200)	($1,200)	($1,300)
General Fund Total	($2,500)	($3,500)	($3,600)	($3,800)

Effective for estates of decedents dying after December 31, 2006

EXPLANATION OF THE BILL

Current Law: There is no exclusion on the Minnesota estate tax return for farm property or small business property.

Proposed Law: The proposal changes the definition of Minnesota adjusted taxable estate. It allows the value of qualified farm property plus the value of qualified small business property to be subtracted from federal adjusted taxable estate when calculating Minnesota adjusted taxable estate. The sum of the two amounts cannot exceed $1,000,000. The proposal defines what is meant by qualified farm property and qualified small business property. For both types of qualified property the following must be true:

- The value of the qualified property was included in federal adjusted taxable estate.
- The decedent continuously owned the property for the three-year period prior to death.
- A family member as defined in IRC Section 2032A(e)(2) will use the property for the trade or business for three years after the decedent's death.
- The estate and the qualified heir who will be the user of the property elect to treat the property as qualified. They agree in writing to pay a recapture tax of 16% of the amount of the exclusion if the agreement for a family member to use the property for the three-year period is not kept. The recapture tax would not need to be paid if the qualified heir were to die within the three-year period after the death of the decedent.

For qualified farm property the following must be true:

- The property meets the definition of a farm under Minnesota law and was classified as the decedent's agricultural homestead for property tax purposes.

EXPLANATION OF THE BILL (Continued)

For qualified small business property the following must be true:

- The property consists of the assets (except publicly traded assets which cannot be included) of a trade or business in which the decedent or the decedent's spouse materially participated in the operation during the most recent taxable year prior to the death of the decedent.
- For the most recent taxable year prior to the decedent's death, the business had gross annual sales of $10,000,000 or less.
- Cash and equivalents cannot be included in the value of the business.

REVENUE ANALYSIS DETAIL

- An estate tax database was created for estate tax returns filed in 2004. The database included information from Minnesota and federal estate tax returns including gross estate, taxable estate, and estate tax. Also included were the types of assets that made up the gross estate such as real estate and stocks and bonds. In addition, the occupation of the deceased, and the birth date and death date were included.
- While it was straight forward to identify deceased farmers from the information on the federal estate tax returns, identifying deceased small business owners was not quite as clear cut. But from the information on the returns, a number of individuals were identified as potentially being small business owners. For both farmers and small business owners, it was not possible to determine if the deceased was retired or not at the time of death.
- Based on partnership information from the Internal Revenue Service, Statistics of Income, various issues, it was estimated that the receipts limit of $10,000,000 for a small business to qualify for the exclusion would be roughly equivalent to an assets limit of about $6,500,000.
- For those individuals identified as farmers or small business owners, assets were identified that could possibly qualify for the exclusion. It was assumed that 90% of real estate, 50% of stocks and bonds, 90% of joint property, and 90% of miscellaneous property could potentially qualify for the exclusion. Other property such as cash, life insurance, and annuities would not qualify.
- The amount of potentially qualifying property was reduced by an estimate of mortgages against the property.
- The amount of potentially qualifying property was limited to $1,000,000.
- Once the property in the estate was identified as being either potentially qualifying for the exclusion or not, spousal and charitable bequests were then used to reduce first the non-qualifying property and then the qualifying property. Any left over qualifying property was then assumed to be used for the exclusion.
- Because of the requirement for the decedent or the decedent's spouse to materially participate in the operation of the business in the case of a small business owner, it was assumed that 100% of the estates would qualify for the exclusion if the decedent died at age 65 or less. If the age at death was 75 or greater, it was assumed that 0% of the estates would qualify. If the age at death was between 65 and 75, the percentage of the estates assumed to qualify was apportioned.

REVENUE ANALYSIS DETAIL (continued)

- In the case of a farmer, because the property must have been homesteaded by the decedent or the decedent's spouse, it was assumed that 100% of the estates would qualify for the exclusion if the decedent died at age 70 or less. If the age at death was 85 or greater, it was assumed that 0% of the estates would qualify. If the age at death was between 70 and 85, the percentage of the estates assumed to qualify was apportioned.
- Once the amount of qualifying property eligible for the exclusion was estimated, the impact on the estate tax was determined. Adjustments were made for estate tax returns that were not available for detailed analysis and for returns where the occupation of the deceased was not listed. After making the adjustments, it was estimated that the impact of the proposal was equal to about 3% of the total estate tax of all returns in the database.
- The above percentage was applied to the February 2007 forecast for the estate tax.
- It is assumed that the returns are filed nine months after the death of the deceased.

Number of Taxpayers: Of the approximately 1,600 returns filed in 2004, about 400 of them were either not available for analysis or did not have an occupation listed for the deceased. Of the approximately 1,200 returns where an occupation was listed, about 200 were identified as farmers and about 150 were identified as possibly being small business owners. A portion of these could be affected by the proposal.

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

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