MINNESOTA · REVENUE

.

ESTATE TAX
Elimination of Three-Year Ownership Rule

March 19, 2012

Preliminary Analysis

	Yes	No
DOR Administrative Costs/Savings		X

Department of Revenue
Analysis of H.F. 2809 (Runbeck) / S.F. 2404 (Chamberlain)

	Fund Impact			
	F.Y. 2012	**F.Y. 2013**	**F.Y. 2014**	**F.Y. 2015**
		(000's)		
General Fund	$0	($4,600)	($24,000)	($45,300)

Effective for estates of decedents dying after June 30, 2012

EXPLANATION OF THE BILL

Current Law: If property in an estate meets the definition of qualified small business property or qualified farm property, the value of such property, up to a maximum of $4 million, may be subtracted from federal adjusted taxable estate in order to determine Minnesota adjusted taxable estate. One of the requirements that must be met by the property is that the decedent must have owned the property for the three-year period ending on the decedent's date of death.

Proposed Law: The three-year ownership requirement would be eliminated. That requirement is replaced by a requirement that the property has to be owned by the decedent on the decedent's date of death. Eliminating the three-ownership would be a departure from common practices in the realm of estate and inheritance taxes and other end-of-life financial concerns. For example, some gifts made within three years of death are included in the federal gross estate of a decedent.

Note: It is unclear how the provision for the decedent to own the property only on the date of death would interact with the material participation requirement for small business property or the homestead requirement for farm property.

REVENUE ANALYSIS DETAIL

- The deductibility of qualified small business property and qualified farm property is a new provision in Minnesota estate tax statutes. As of yet, no data is available regarding how often the deduction of qualified small business property and qualified farm property will occur.
- The elimination of the three-year ownership requirement would likely make the deduction available to a greater number of estates. It would also open up new opportunities for estate tax planning.
- The estate tax database for estate tax returns filed in 2008 was used for this analysis. The database included information from Minnesota and federal estate tax returns including gross estate, taxable estate, and estate tax.

REVENUE ANALYSIS DETAIL (Cont.)

- Since tax planning practitioners are involved in estate tax planning, it is likely that significant use will be made of the opportunity to create small business or farm operations shortly before death in order to take advantage of the small business and farm deduction.
- For purposes of this analysis, it was assumed that the average extra deduction from the taxable estate for the estates in the database would be $2,000,000 (or taxable estate, whichever is less) even though the deduction could have been as high as $4,000,000.
- After reducing the taxable estate by the additional $2,000,000 (but not to a taxable estate of less than zero), the estate tax was recalculated for each return in the database.
- Upon recalculation of the estate tax due to the extra $2,000,000 deduction, it was determined that the reduction in the estate tax after the recalculation was about 63% on average for the entire database.
- Adjusting the reduction for tax law changes that were enacted previously in 2011 but are not reflected in the 2008 estate tax database, the reduction in the estate tax after the recalculation was about 42%.
- The 42% reduction was applied to the February 2012 estate tax forecast.
- The reduction was phased in based on the date of death of the decedent. For dates if death during the first, second, and third years after the effective date, the phase-in percentages were 30%, 60%, and 90% respectively.
- It is assumed that returns are filed and tax is paid nine months after the death of the decedent. The estimate for fiscal year 2013 reflects the impact of the bill for deaths that occur in July, August, and September 2012.

Number of Taxpayers: In the 2008 estate tax database, there were about 1,000 returns with estate tax greater than zero.

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

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