MINNESOTA · REVENUE

ESTATE TAX
Recapture Tax

April 4, 2012

	Yes	No
DOR Administrative Costs/Savings		x

Department of Revenue
H.F. 2690 (Davids), 1st Engrossment, Article 1

	Fund Impact			
	F.Y. 2012	**F.Y. 2013**	**F.Y. 2014**	**F.Y. 2015**
		(000's)		
General Fund	$0	($1,000)	($1,100)	($1,100)

Effective for estates of decedents dying after June 30, 2011.

EXPLANATION OF THE BILL

Current Law: Legislation enacted in 2011 provides a deduction for qualified small business and farm property. If certain qualifications are met, the value of the qualified property may be deducted from the taxable estate up to a maximum of $4 million. One of the requirements that must be met in order for the executor of an estate to take a small business or farm deduction on the state return is that the inherited small business or farm property must be retained by the qualified heir for three years after the death of the decedent. If the qualified heir disposes of any interest in the qualified property, other than by a disposition to a family member, an additional estate tax called the recapture tax is imposed. The amount of the recapture tax is equal to 16% of the amount of the deduction claimed by the estate when the estate tax return was filed.

Proposed Law: The bill would change the conditions under which the recapture tax is imposed. The heir would have broader opportunities to dispose of qualified property while still avoiding the recapture tax. The broadened opportunities for disposition come about by allowing a qualifying entity to be the recipient of the qualifying property in addition to a family member. A qualifying entity is defined to be a corporation or other entity owned by a family member or family members that is not excluded from owning agricultural land under M.S. Section 500.24.

Also, if the recapture tax is imposed, the amount of the recapture tax is reduced. The reduction in the tax amount occurs because, under the bill, the recapture tax would be imposed only on the portion of the property that was disposed of, rather than on the amount of the deduction claimed by the estate when the estate tax return was filed.

Also, the bill clarifies administrative procedures for filing the recapture tax return.

Note: In the definition of qualifying entity, it should probably be made clear that the restrictions imposed by M.S. Section 500.24 apply only to the farm land deduction and not to the small business deduction.

REVENUE ANALYSIS DETAIL

- The proposed definition of qualifying entity requires that the entity be owned by a family member or family members. There is no requirement that the entity be wholly owned by the family. As a result, some or nearly all of the qualifying property could be converted to cash by disposing of the property to nonfamily members. As long as the qualified heir retained at least a small interest in the qualifying entity, no recapture tax would be imposed, assuming all other requirements continued to be met.
- By providing a way to dispose of some of the qualifying property in favor of cash while still retaining the opportunity to take the small business and farm deduction, the provision is at odds with other parts of the estate tax statutes (M.S. Section 291.03, Subdivision 9, clause (4), and M.S. Section 291.03, Subdivision 10) which specifically exclude cash from qualifying for the deduction.
- Because of the broadened opportunities to dispose of qualifying property without incurring a recapture tax, a larger number of estates may use the small business or farm deduction.
- As an example, consider a situation where two siblings inherit qualifying small business property. One of the siblings wants to continue to operate the business; the other wants to liquidate most of his or her interest in the business. Without the broadened opportunities to dispose of qualifying property without incurring a recapture tax, it would be less likely that the small business deduction would be claimed when the estate tax return is filed. By broadening the opportunities for disposition, the siblings can claim the deduction. Then the disposition can take place, a nonfamily member can take over a large portion of the business, one of the siblings gets cash, and there is a loss of revenue for the state.
- 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 small business property and farm property will occur.
- Previous estimates of the impact of the small business and farm deduction were made using the estate tax database for estate tax returns filed in 2008. The total of those estimates was a 7% reduction in estate tax revenue.
- For purposes of this estimate, it is assumed that the increased revenue loss due to increased use of the deduction for qualified property is 10% of 7% or 0.7%.
- The 0.7% reduction was applied to the February 2012 estate tax forecast.
- It is assumed that returns are filed and tax is paid nine months after the death of the decedent. Because of the retroactive effective date, the fiscal year 2013 impact was not reduced for timing.

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