ESTATE TAX
Modifications to Small Business and Farm Deductions

April 2, 2013

	Yes	No
DOR Administrative Costs/Savings		X

Department of Revenue
Analysis of S.F. 900 (Koenen) / H.F. 1092 (Poppe)

	Fund Impact			
	F.Y. 2014	**F.Y. 2015**	**F.Y. 2016**	**F.Y. 2017**
		(000's)		
General Fund	$9,200	$14,600	$20,400	$26,800

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

EXPLANATION OF THE BILL

Current Law: The Minnesota estate tax statutes were changed in 2011 to allow executors of the estates of small business owners and farmers to deduct from the taxable estate up to $4 million for qualified small business property or qualified farm property. The statutes specify various requirements the small business property and the farm property must satisfy in order for the property to be considered qualified.

Proposed Law: Under the proposal, some of the requirements are either clarified or modified. Those clarifications and modifications are as follows:

- The definition of "family member" is broadened to include certain qualifying trusts. This would allow for trust planning which would otherwise be disallowed.
- It is made clear that ownership interest includes the interest in transferred property the decedent is deemed to own under estate tax sections 2036, 2037, and 2038 of the Internal Revenue Code.
- For small businesses,
    - It is made clear that the decedent or the decedent's spouse must have materially participated in the business during the decedent's taxable year that ended before the decedent's death. The business must not have been a passive activity.
    - The definition of qualified small business property is modified to exclude assets that are not actually used in the business.
    - The proposal allows that, for sole proprietors, property replaced by similar property within three years of death will be treated as having been owned for the required three-year period.
    - The proposal requires that a family member must materially participate in the operation of the business during the three-year period following the decedent's death. The business must not be a passive activity.

EXPLANATION OF THE BILL (Cont.)

- For farms,
  - The definition of farm property is clarified. It is made clear that farm property must be owned by a person or entity that is not excluded from owning farm property by M.S. section 500.24. The decedent must have owned the property for the three-year period ending on the decedent's date of death.
  - The proposal changes the requirement that a family member uses the property in the operation of the business for three years following the death of the decedent to a requirement that the property be classified as class 2a agricultural homestead under M.S. 273.13, subdivision 23, for three years following the death of the decedent. This allows the family member of the decedent to either farm or rent out the property regardless as to whether or not the decedent had been farming or renting out the property.
- The recapture tax would not be imposed if the qualified heir of a sole proprietor were to replace qualified business property with similar property during the three-year period following the death of the decedent.

REVENUE ANALYSIS DETAIL

- The deductibility of qualified small business property and qualified farm property is a recent provision in Minnesota estate tax statutes. While information is starting to be collected regarding how often the deduction of qualified small business property and qualified farm property is occurring, it is not known if any of these deductions would have been affected by the provisions of the proposal.
- The estimate is based on the February 2013 forecast.
- 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.
- After the small business and farm property deductions were enacted in 2011, it came to light that some additional changes were needed in order for the statute to be consistent with what was thought to be legislative intent and the estimates made at the time of enactment. From information in the 2008 estate tax database it was estimated that estate tax collections could be reduced by as much as an additional 12.5% if the additional changes were not put in place. Since the additional changes were not enacted in 2012, the February 2013 estate tax forecast was reduced accordingly.
- It was assumed that the full impact of not making changes would be phased in over time. Because the changes are made in this bill, the revenue gain is based on the reduction made in the forecast. For purposes of this analysis, the phase in is as follows: 0% for 2013, 40% for 2014, 60% for 2015, 80% for 2016, and 100% for 2017.

REVENUE ANALYSIS DETAIL (Cont.)

Number of Taxpayers: While the estate tax database for returns received in 2012 is still not quite complete, the database currently contains about 2,000 estate tax returns. About 1,200 of the returns have an estate tax amount greater than zero. About 100 of the returns claimed a small business or farm property deduction.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.revenue.state.mn.us/research_stats/Pages/Revenue-Analyses.aspx

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