

The Minnesota Estate Tax

The estate tax equals a percentage of the taxable estate

Minnesota imposes a tax on the estates of individuals who are residents of the state when they die or who own tangible property (typically real estate) in Minnesota when they die. The tax is imposed under a graduated rate schedule on the taxable estate. The taxable estate is generally the fair market value of the estate on the day the decedent died, less deductions (e.g., transfers to a surviving spouse and charitable bequests) and an exemption amount.

Legislation in 2014 increased the exemption amount in steps to \$2 million by 2018 (*see box*) and provided that calculation of the tax would be based on a state tax rate schedule, rather than the state credit under prior federal law. Tax rates range from 10 percent to 16 percent for 2015 deaths. The top rate applies to the amount of the taxable estate over \$10,100,000. The 2014 legislation modifies the rate structure each year as the exemption amount increases so that the increases will largely benefit lower valued estates.

Exemption Amount

The exemption amount is \$1.4 million for 2015 deaths. The exemption amount increases by \$200,000 per year until it reaches \$2 million in 2018. Because transfers to surviving spouses are exempt, a married couple can exempt joint net worth of twice the exemption amount (\$2.8 million in 2015) if they structure transfers to trusts appropriately.

Gifts made within three years of death are included in the estate

The 2013 Legislature enacted a gift tax to complement the estate tax. This legislation also subjected gifts made within three years of death to the estate tax; this rule only applies to gifts that are subject to the federal gift tax (i.e., that are above the annual per-recipient exemption, currently \$14,000 indexed for inflation). The 2014 Legislature repealed the gift tax, but the three-year rule remains in effect, subjecting these gifts to the estate tax.

An exclusion for qualifying small business property and homestead farmland applies

Legislation passed in 2011 provided two special exclusions for qualifying small business property and homestead farmland, effective for decedents dying after June 30, 2011. The combined value of these exclusions and the general exemption amount cannot exceed \$5 million. As the general exemption increases under the 2014 law, the maximum amount of these special exemptions decline (i.e., the \$5 million maximum continues to apply).

The decedent or spouse must have owned the qualifying property for three years before the date of death, and the heirs must own and use the property in the business (or as a farm homestead) for three years after the date of death. Failure to do so triggers a recapture tax equal to 16 percent of the value of the property.

Few estates pay the tax; it is a progressive source of revenue

Fewer than 2 percent of estates pay the estate tax. The small number of estates paying tax results from the exemption amount and the fact that amounts left to surviving spouses are deductible. The Department of Revenue (DOR) estimates that the 2014 increases in the exemption amount, when fully phased in, will reduce the number of estates subject to tax by almost 37 percent.

Based on DOR's *Tax Incidence Study*, the tax is the most "progressive" state tax. Decedents with taxable estates are some of the most affluent individuals in the state. Most evidence also suggests that recipients of bequests from taxable estates have above-average income and assets.

The estate tax provides a modest, but volatile, source of general fund revenue

Revenues from the tax are deposited in the general fund. *See the box for the last five years of collections.* Revenues from the tax are volatile, since they depend on the deaths of a few individuals. If one very wealthy individual dies, collections can soar. In other years, revenues may fall below estimates. For example in August 2005, DOR received tax revenues of \$112 million from one estate, while total collections were \$73 million in the prior year.

2010	\$148,977
2011	\$161,202
2012	\$165,277
2013	\$158,928
2014	\$177,433

Source: Minnesota Dept. of Revenue

DOR estimates that the 2014 increases in the exemption amount and new rate structure will reduce fiscal year 2017 revenues by about \$64 million, reducing the tax's revenues by almost 30 percent.

State estate taxes create incentives for high net worth individuals to move to no-tax states

For many years (1985-2001), Minnesota imposed a "pickup" estate tax equal to the now-repealed federal credit for state death taxes. Under this system, the federal treasury bore the effective burden of the tax—the state tax reduced federal tax dollar-for-dollar. As a result, Minnesota residents had no reason to move to another state to avoid the tax. However, with the 2001 repeal of the federal credit in 2001, the state tax became a "real" tax that reduces the amount of property that can be left to heirs.

Avoiding the tax requires changing one's permanent home (domicile) to another state or reducing the amount of Minnesota property owned. Affluent individuals may be willing to change their domiciles to avoid paying potentially multimillion-dollar state estate tax liabilities. The fact that many of these individuals have second homes in states without estate or inheritance taxes increases their ease of moving. Most states (31 in 2015) do not have estate or inheritance taxes. Several of these states also have no income tax, allowing individuals who change their domiciles to those states to avoid both taxes.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research short subject *Estate and Inheritance Taxation: An Overview of the States*, July 2014 and Minnesota Department of Revenue, *Minnesota Estate Tax Study* (2014) for more detailed information.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.