TECP E-Alert: Big Changes to Minnesota Estate and Gift Taxes

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On March 21, 2014, Minnesota lawmakers passed a tax bill that has a major impact on many Minnesota residents and non-residents who own property in Minnesota. The press is largely focusing on the income and business tax changes, but the estate and gift tax changes are also significant. We are happy to report that most clients will benefit from these changes, because more assets can pass to family members free of Minnesota estate tax.

Minnesota Decoupled from Federal Estate Tax in 2002

In 2001, Congress increased the federal estate tax exclusion from $675,000 to a maximum of $3.5 million by 2009. In 2010, Congress increased the exclusion to $5 million indexed for inflation for 2010, 2011, and 2012. Then, at the end of 2012, Congress enacted a permanent estate tax exclusion of $5 million indexed for inflation ($5.34 million in 2014). In 2002 Minnesota chose to freeze its estate tax exclusion amount at $1 million. For the next ten years, while Congress made many changes to the federal estate tax, the Minnesota estate tax was largely unchanged (with the exception of adding a Minnesota qualified small business and qualified farm property deduction and a few other minor tweaks). Then, in 2013, Minnesota enacted a gift tax to go along with the estate tax, a three-year look back on certain taxable gifts, and an estate tax on certain interests held in a pass-thru entity. Late last month, in response to a number of factors, Minnesota made some noteworthy changes.

Estate Tax Exclusion Increase

The new law raises the Minnesota estate tax exclusion from $1 million to $2 million over the course of the next five years as follows:

Year	Minnesota Exclusion
2014	$1.2 million
2015	$1.4 million
2016	$1.6 million
2017	$1.8 million
2018 and beyond	$2.0 million

The new law also raises the tax rates in the middle range of the brackets (for example, from a 6.4% marginal rate to a 9% marginal rate in 2014 on the same dollars). The new Minnesota estate tax rate starts at 9% of the amount over $1.2 million and caps out at 16% for amounts over $10.1 million (note that the 9% rate is replaced by 10% after 2014).

Elimination of the "Tax Bubble"

The new law eliminates the so called "tax bubble," which previously applied to estates between $1 million and $1,093,784 (where the old federal marginal estate tax rate of 41% applied instead of the Minnesota estate tax marginal rate). Under the old system, for an estate valued at $1.1 million, the Minnesota estate tax owed was $38,800, but, for a $2 million estate, only $99,600 of estate tax would be owed. With the elimination of that bubble, assets immediately over the threshold are now taxed at a marginal rate of 9% or 10%.

Retroactive Repeal of the Gift Tax but Certain Lifetime Gifts Included in Taxable Estate

The new law retroactively repeals the gift tax, so there is no longer a separate gift tax in Minnesota. However, the Minnesota taxable estate for 2014 and beyond includes the value of all federal taxable gifts made within three years of death (previously, this included only Minnesota gifts made after June 30, 2013 and also made within three years of death). There is a proposal before the Minnesota legislature to limit this look back to gifts made after June 30, 2013. Another significant change is the elimination of certain federal elections unless a federal estate tax return is **required** to be filed. Most notably, this will have a significant impact on estates of decedents with a non-citizen spouse that do not require a federal return, because assets that pass to a non-citizen spouse will not qualify for the Minnesota marital deduction. It is possible but not certain that this will be dealt with in the Omnibus bill later this session.

Benefit to Certain Estates

The new law will mostly benefit estates below the new Minnesota exclusion amount because those estates will no longer need to file an estate tax return or pay Minnesota estate tax. Estates under $3 million will also see more estate tax savings than larger estates in 2014. The estate tax difference for an estate with $1.1 million in assets from 2013 versus 2014 under this new law is $38,800 in tax savings (plus savings for not preparing and filing an estate tax return).

Not Much Benefit for Estates over $3 Million

The tax savings for estates over $3 million is not very significant in 2014. For an estate of $3.6 million to $5.8 million, the total estate tax savings is a flat $800 in 2014 (compared to 2013). For estates of $5,830,500 and larger, the total estate tax savings is a flat $480 in 2014 (compared to 2013). In 2018, the total estate tax savings on estates $7.1 million and up will be merely $3,480 per year in comparison with the 2013 tax laws. In other words, estates of $7.1 million and up only get $3,480 of tax benefit from the extra $1 million of Minnesota estate tax exclusion in 2018 and beyond.

What Now?

For more than a decade, Minnesota estate and gift taxes were left nearly untouched. Now, in less than one year, lawmakers have raised the Minnesota estate tax exclusion; eliminated the “tax bubble” and some federal elections; and passed and repealed the Minnesota gift tax. These changes might not get the headlines in the press, but they have a real impact on many Minnesota residents.

As a result of these changes, we suggest that our clients take some time to review their estate plans to ensure that the rising exclusion amounts do not have unintended consequences. For many clients, this will just mean more assets pass to family members free of Minnesota estate tax. Please contact your Gray Plant Mooty attorney to determine the impact that these changes might have on your plan.

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