

Qualifying for the Minnesota Qualified Farm Property Deduction

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The qualified farm property deduction is a means of greatly reducing Minnesota estate tax liability for certain owners of agricultural land. This deduction has undergone some significant changes since its initial enactment in 2011. The law, as it is written now, makes it accessible to many more beneficiaries who would like to claim the deduction. Planning to ensure the land qualifies for this deduction begins during the agricultural land owner's life, and planners should be aware of how agricultural land owners can ensure their estates are eligible for this deduction.

In order to be qualified, the farm property must meet several requirements. First, the property must be included in the decedent's federal adjusted taxable estate. There are a variety of ways that property not owned outright by an individual will be included in that person's estate. For example, if a farmer retains a life estate on the agricultural land, the farm will be included in the farmer's estate for estate tax purposes under I.R.C. § 2036.

Second, the property must be agricultural land that is owned by a person or entity that is either not subject to or is in compliance with Minnesota Statutes § 500.24, which is commonly referred to as the Corporate Farm Statute. The Corporate Farm Application can be found at www.mda.state.mn.us. The application must be filed with the Minnesota Department of Agriculture. The Minnesota Department of Agriculture will send out annual letters to all certified entities to ensure that the information on file is current.

Third, the property must be classified for property tax purposes in the taxable year of decedent's death as agricultural homestead, agricultural relative homestead, or special agricultural homestead under Minnesota Statutes § 273.124. For this reason, it is very important that the owner continue to maintain the homestead classification during life, even if the owner no longer lives on the farm.

There are various instances in which the agricultural homestead classification is not available, especially when the owner does not live on the property. The availability of the homestead classification can be affected by who the land owner leases the property to, whether that person or entity is actively farming the land, where the person actively farming lives in comparison to the land, and the size of the agricultural property, among others. For example, if the land owner owns the property in his name individually and leases the property to his son, but both the son and owner live five townships from the agricultural property, then it is not eligible for agricultural homestead classification. The requirements and disqualifications quickly become complicated. It is also important to note that property owned by a trust or by an authorized entity goes through a slightly different set of considerations for homestead classification than property that is owned outright.

Fourth, the property must have been classified for property tax purposes in the taxable year of death as class 2a property under Minnesota Statutes § 273.13, subd. 23. Eligibility for this classification is generally much more straightforward than eligibility for the agricultural

homestead. The requirements the land must meet in order to be classified as class 2a land are the following:

1. At least 10 contiguous acres must be used to produce agricultural products in the preceding year (or by qualifying land enrolled in an eligible conservation program);
2. The agricultural products are defined by statute; and
3. The agricultural product must be produced for sale.

The county assessor may have to make some judgment calls to determine whether each of these requirements is met.

Finally, the decedent must have continuously owned the property for the three-year period ending at the decedent's death. Property that is deemed to have been owned by the decedent during those three years under I.R.C. §§ 2036, 2037, and 2038 meets this ownership definition. This ownership requirement can be met if the decedent owned the agricultural land in his name individually or if he owned an interest in an entity that complies with or is not subject to the Corporate Farm Act.

In addition, the qualified heir must meet certain requirements in order to elect the deduction. The estate and qualified heir must file an M706Q with the state of Minnesota electing to claim the qualified farm property deduction. In this filing, each qualified heir must agree to pay the recapture tax, if applicable. By signing the form, each qualified heir is guaranteeing that he or she will file two informational returns confirming that no recapture tax is due or, if necessary, pay any recapture tax. The first return must be submitted 24 to 26 months after the decedent's death, and the second return is due 36 to 39 months after the decedent's death.

A family member must actually maintain the 2a classification for the land for three years following the decedent's death. The family member does not have to be a qualified heir; instead, the person or trust must simply be a family member as defined in I.R.C. § 2034A(e)(2). The informational returns must show that the qualified heir has continuously maintained the land's 2a classification. There is no requirement that the homestead classification be maintained, nor is there any requirement that any of the qualified heirs farm on or live on the property.

On occasion, farm property is also eligible for the qualified small business deduction. If the heirs elect the qualified small business deduction rather than the farm property deduction, there are additional requirements both for the decedent's involvement in the business and for the qualified heir's future involvement. Sometimes, this election is preferable because there are significantly more assets that can be included in the deduction and the decision regarding which to use should be considered on a case by case basis.

The qualified farm property deduction has resulted in some different planning strategies for many Minnesota farmers, especially those that have estates above the Minnesota estate tax exemption but below the federal estate tax exemption. Now, many farmers may find it possible to get the step-up in basis at death and still avoid any estate tax liability.