

HOUSE RESEARCH

Bill Summary

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Authors: Lenczewski

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Analyst: Joel Michael, joel.michael@house.mn

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Overview

This bill, as amended by the delete everything amendment, substantially restructures the estate and gift taxes. The changes include:

- Unifying the two taxes to providing one (that is, a combined) exemption of \$1.5 million for both taxes (rather than separate \$1 million exemptions under each of the taxes as under present law).
- Modifying the rate structures to be a unified stand-alone tax (rather than being based on the old federal credit for state death taxes for the estate tax or a flat 10 percent rate in the case of the gift tax) with rates ranging from 10 percent to 18 percent.
- Imposing a new penalty for failing to file a gift tax return, regardless of whether tax liability is generated by the gift if the donor has sufficiently high net worth to make it likely that the donor's estate will be subject to estate tax.
- Providing special gift tax rules for certain Grantor Retained Annuity Trusts (GRATs) with terms of less than 10 years or that are "zeroed out."
- Making technical and administrative changes, particularly to make the gift tax administrative and compliance provisions consistent with the estate tax.

The gift tax changes are generally effective retroactive to the original enactment of the gift tax (i.e., for gifts made after June 30, 2013), except that the increase in the tax rate under the unified structure would only apply to gifts made after December 31, 2013. The estate tax changes are effective for estates of decedents dying after December 31, 2013.

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- 1 **Transferee liability.** Extends the transferee liability under the estate tax to the gift tax. This makes the recipient of a taxable gift liable for the tax, if the donor fails to file and pay. It replaces a provision in section 292.17, which is eliminated in section 28. The obligation of a personal representative to pay, if the donor dies before paying, parallels federal law. These provisions replace similar provisions in section 292.21, which is repealed by section 35.
- 2 **Tax administration.** Adds the gift tax to chapter 289A, the general tax administration chapter that also applies to the estate tax, as well as the individual income, corporate, sales, and mining occupation taxes.
- 3 **Definitions.** Adds a reference to the gift tax chapter's definitions in chapter 289A.
- 4 **Return requirement.** Modifies the return filing requirement to reflect the increase in the exemption amount in section 24 and to include all lifetime taxable gifts (present law is limited to taxable gifts made within three years of death).
- 5 **Gift tax return.** Transfers the gift tax return filing requirement from chapter 292, the gift tax chapter, to chapter 289A, the general tax administration chapter.
- 6 **Gift tax return; documents required.** Adds the gift tax to the commissioner's authority to specify what documents must be filed with the tax return.
- 7 **Gift tax return; definitions.** Provides definitions under the gift tax chapter apply to the estate and gift tax return section.
- 8 **Estate tax return.** Eliminates obsolete language relating to estate tax returns for deaths during 2010.
- 9 **Gift tax return, filing deadline.** Specifies gift tax returns must be filed by April 15 of the year following the year in which the gift was made. (This is transferred from section 292.19, which is repealed by section 35.)
- 10 **Estate tax returns, extensions.** Makes nonsubstantive changes in the language providing for extensions of time to file estate tax returns.
- 11 **Gift tax returns, extensions.** Provides that the federal extensions to file gift tax returns also apply to Minnesota gift tax returns.
- 12 **Gift tax payment date.** Specifies gift tax must be paid by April 15 of the year following the year in which the gift was made. (This is transferred from section 292.21, which is repealed by section 35.)
- 13 **Extensions to pay estate tax.** Makes nonsubstantive changes in the language providing for extensions of time to pay estate tax.
- 14 **Extensions to pay gift tax.** Authorizes the commissioner to extend the time to pay gift tax for good cause and extends the time to pay, if a federal extension applies.

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- 15 Audit and assessment authority.** Provides that the commissioner's authority to audit and assess estate tax also applies to the gift tax.
- 16 Statute of limitation extension; omissions of 25 percent or more.** Provides the extension of the statute of limitations to 6-1/2 years applies to omissions of taxable gifts of 25 percent or more. This parallels the similar provision under income, sales, and estate taxes.
- 17 Notification of federal changes.** Adds gift tax to the statute requiring taxpayers to notify the commissioner of changes reported to, agreed to or ordered by the Internal Revenue Service on the federal return. This requirement is currently in chapter 292.
- 18 Refunds of gift tax.** Adds gift tax to the chapter 289A provision providing for refunds of overpayment of taxes. This requirement is currently in section 292.21, which is repealed by section 35.
- 19 Interest on gift tax refunds.** Provides interest on refunds will be paid from the latest of (1) the overpayment, (2) the due date of the return, or (3) the date the original return was filed.
- 20 Penalty, failure to pay gift tax.** Applies the late payment penalty applicable generally to other taxes to the gift tax.
- 21 Penalty, failure to file gift tax return.** Provides that failure to file a gift tax return is subject to a penalty equal to the greater of (1) 5 percent of the unpaid tax or (2) a penalty for failure to file a nontax return for a gift of \$100,000 or more. The penalty for failure to file a nontax return equals the lesser of:
- 5 percent of the gift (not the tax); or
 - 5 percent of the donor's net worth in excess of \$1.5 million (\$3 million for a married couple), but not more than \$25,000.
- 22 Estate tax definitions.** Eliminates the definition of "adjusted taxable estate" to reflect that section 23 changes the tax computation to be based on the Minnesota taxable estate.

The restriction on the definition of personal property with a Minnesota situs to that given within three years of death is eliminated. This reflects that computations will take into account all taxable gifts made after June 30, 2013, the effective date of the gift tax, and makes the estate and gift taxes consistent.

A "qualified work of art" is defined as a work of art, as provided by the federal estate tax, that is owned by a non-resident and on loan to a Minnesota art museum or similar charity. These works of art are treated as not having a Minnesota situs. This ensures that a nonresident decedent's loan of a work of art to a Minnesota art museum will not trigger an obligation to file or pay Minnesota estate tax.

Expands the look-through provision that applies to Minnesota property owned by a pass-through entity to apply to the gift tax, as well as the estate tax, by striking the limitations to property owned by a decedent. (The estate tax definitions also apply to the gift tax.)

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Provides that the prohibition under the income tax statute on considering charitable contributions in determining domicile applies to the estate tax. For example, this would prohibit DOR from taking into account that an estate's charitable contributions were made to Minnesota charities in determining the domicile (residence) of the decedent.

23 Minnesota taxable estate. Defines Minnesota taxable estate, the tax base to which the rates under section 24 apply, as the result of the following computation:

1. Federal taxable estate, plus
 - a. The deduction for state and foreign death taxes
 - b. The amount of taxable gifts made after June 30, 2013 (i.e., gifts subject to Minnesota gift tax)
 - c. Any Minnesota gift tax paid by the decedent within three years of death (this parallels the similar computation under the federal estate tax for federal gift tax); less
2. The value of qualified small business and farm property, but not to exceed \$3.5 million

24 Estate tax computation. Creates a stand alone estate tax rate schedule and increases the estate tax exemption from a *de facto* \$1 million amount (which is not a true exemption because estates with values just above the exemption amount are subject to higher effective tax rates) to a true exemption of \$1.5 million:

Minnesota taxable estate	Tax rate
\$1.5 million or less	0
\$1.5 million up to \$4 million	12%
\$4 million up to \$6 million	14%
\$6 million up to \$10 million	16%
Over \$10 million	18%

Under present law, the tax rate schedule is based on the intersection of the repealed federal credit for state death taxes, the old federal estate tax rate schedule, and the old federal unified credit. These complex computation result in a rate schedule that imposes no tax on estates (including taxable gifts made within three years of death) of \$1 million or less; a 41 percent tax on the value of the estates between \$1 million and about \$1,094,000, and rates ranging from 5.6 percent to 16 percent (with the top rate applicable to estate values over \$10,100,000).

Residents would pay tax on the entire value of their estates, which differs from present law under which tax applies only to the Minnesota proportion of the gross estate. If another state

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taxes the property (because the property has a situs in another state with a tax), a credit would apply under section 26.

Nonresidents would compute their tax by determining the tax on the total estate and multiplying it by a fraction, the numerator of which is Minnesota situs property (including Minnesota taxable gifts made after June 30, 2013) in the estate and the denominator of which is the total value of the estate (including any taxable gifts). This is similar to the computation under present law and that is used for nonresidents under the individual income tax.

25 QTIP election. Provides that Minnesota taxable estate reflects the value of qualified terminable interest property (QTIP) elections allowed under federal law. An estate may make this election for Minnesota purposes, even if it is not required to file a federal return. (Under present law, Minnesota only recognizes QTIP elections made under the federal estate tax.) If the estate is required to file a federal return, the QTIP election must be made consistently for federal and Minnesota purposes.

Background. QTIP trusts are a standard estate tax planning tool for married couples. They allow electing the amount of the trust that will qualify for the marital deduction. The value of the QTIP property qualifies for the marital deduction (avoiding estate tax on the death of the first spouse), although only a limited income interest is provided to the surviving spouse. To be QTIP property:

- The property must be owned by the decedent.
- The surviving spouse must have a right to all of the income, payable at least annually, from the property for life.
- No one else may have a power of appointment over the property until the surviving spouse dies.
- A QTIP election must be made.

26 Credits. Allows the following credits against estate tax:

- Minnesota gift tax paid on gifts included in the taxable estate, unless the property was deductible as qualified farm or small business property
- Inheritance or estate tax paid by the estate of a resident decedent on property included in the taxable estate to another state; this credit cannot exceed the Minnesota tax attributable to the property
- Inheritance or estate tax paid by the estate of a nonresident decedent to another state on property subject to Minnesota estate tax because the property is owned by a pass-through entity (This credit is allowed under present law, section 291.03, subdivision 1c, which is repealed by section 35, and moved to the new general credit section of the estate tax.)

27 Gift tax definitions. Adds a definition of Minnesota taxable gifts that excludes gifts of

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tangible property located outside of Minnesota when the gift is made by a nonresident. (This is currently provided by an exclusion from the tax base, which is repealed by section 35.) This new definition will subject gifts of tangible property located outside Minnesota (e.g., real estate in another state) to gift tax, if the donor is a Minnesota resident.

This section also:

- Changes the definition of resident by eliminating the cross reference to the income tax and specifically providing that residency is based on domicile when the gift was made.
- Clarifies that donations to section 527 political organizations are not subject to tax and that contributions to 529 Plans receive the same treatment as under the federal gift tax. (Both of these confirm administrative guidance provided by DOR.)
- Provide special rules for Grantor Retained Annuity Trust (GRATs) gifts that either are treated as having no fair market value for federal gift purposes (often referred to as zeroed-out GRATs) or have terms of ten years or less. These GRATs may be subject to Minnesota gift tax in the year the grantor's interest terminates. Unless the GRAT terminates (returning the property to the grantor), the tax would apply to the lesser of the (1) fair market value of the property on the date of the termination (that is, the appreciation that has accrued to the recipient of the gift) or (2) the value of the donor's interest in the GRAT as originally disclosed to the IRS.

Background. GRATs are a transfer tax planning technique that involves the donor conveying property (e.g., stock or another interest in a business) to a grantor trust property, while retaining a qualifying income interest. The qualifying income interest is valued under IRS rules and reduces the amount that is deemed to be conveyed to the beneficiary of the trust and, thus, that is subject to gift tax. This mechanism is used to convey future appreciation of the trust's assets (above the IRS discount rate) to the recipient free of gift tax. If the assets fail to appreciate above the IRS discount rate, they are returned to the grantor. The proposal would impose gift tax on the transferred appreciation (but not to exceed the IRS value of the retained interest), if the GRAT is either zeroed out (i.e., qualified interest equaled or exceeded the fair market of the asset at the time of the trust was created) or had a term of less than 10 years. The gift tax on this amount would apply in the year the GRAT terminates.

- 28 Imposition.** Eliminates the ten-percent tax rate, which is replaced by the graduated rate structure in section 29, and eliminates the specification of liability, which is replaced by the provision in section 1 and amendments to chapter 298A.
- 29 Tax rates.** Replaces the flat ten-percent rate of the gift tax under present law with graduated rates equal to the estate tax rates under section 24.
- 30 Application of federal rules.** Provides that the commissioner has authority to apply federal gift tax rules in administering the tax. This language is moved from section 292.21, which is repealed by section 35.

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- 31 QTIP election.** Allows a Minnesota QTIP election for gift tax purposes under rules similar to those provided in section 25 for the estate tax.
- 32 Credits.** Provides the following gift tax credits:
- Gift tax paid on prior returns – this ensures that the graduated rates apply on a lifetime basis to the sum of the donor’s gifts over the lifetime exemption amount.
 - Nonresident tax credit – this is similar to the nonresident estate tax credit as described in section 26 that ensures that a gift of Minnesota property held in a pass-through entity that is subject to both Minnesota gift tax and that of another state is not double taxed. (At present, only Connecticut imposes a gift tax; however, a number of states include gifts made in contemplation of death or a short time before death in their estate or inheritance taxes.)
- 33 Appraisals of property.** Makes a cross reference change to reflect the changes in section 27.
- 34 Definition of taxable gift for decedents dying before January 1, 2014.** Provides a definition of taxable gift for estate tax purpose for decedents dying in 2013, parallel with the bill’s provisions in section 27. This confirms DOR’s administrative policies.
- 35 Repealer.** Repeals the following statutes (most of which are replaced by provisions moved to chapter 289A):

Statute	Description
291.03, subd. 1b	QTIP property for decedents dying in 2010 – obsolete
291.03, subd. 1c	Nonresident decedent estate tax credit – replaced by section 26
291.41 – 291.47	Uniform act to resolve interstate disputes over domicile – this statute has never been used by DOR
292.17, subd. 2 and 3	Gift tax’s lifetime credit and exclusion for out-of-state gifts – this is replaced by the tax rate schedule and the allowance of a credit for gift tax paid in prior years under sections 29 and 32
292.18	Gift tax return requirement, replaced by sections 5 and 6
292.19	Gift tax filing requirements, replaced by sections 9 and 11
292.21	Gift tax administrative provisions, replaced by various amendments to chapter 289A