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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 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. Before the increases enacted in 2014 fully took effect, legislation enacted in 2017 further increased the exemption to $3 million for 2020 (*see table for details of changes in exemption amounts).* Tax rates range from 12 percent to 16 percent for 2017 deaths; bottom rate increases to 13 percent in 2018. The top rate applies to the amount of the taxable estate over $10,100,000.

History of Exemption Amount

CY of Death	Exemption
2006 – 2013	$1,000,000
2014	1,200,000
2015	1,400,000
2016	1,600,000
2017	2,100,000
2018	2,400,000
2019	2,700,000
2020	3,000,000

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 The 2014 Legislature repealed the gift tax, but the three-year rule remains in effect, subjecting these gifts to the estate tax.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 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, the maximum amount of these special exemptions decline (i.e., the overall $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 the land must continue to be classified as agricultural property for property tax purposes) 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.

Based on Department of Revenue's (DOR) *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 incomes.

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 table for the last five years of collections.*) Revenues from the tax are volatile. Fiscal year 2015 revenues were 18 percent lower than the prior year and, then, increased by 26 percent in the following fiscal year (2016). 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; total collections were $73 million in the prior year.

Estate Tax Revenues FY 2012 – 2016 (thousands)

2012	$165,277
2013	$158,928
2014	$177,433
2015	$145,292
2016	$183,216

Source: Minnesota Dept. of Revenue

DOR estimates the $1 million increase in the exemption, enacted in 2017, will reduce revenues by about 25 percent when fully effective. The number of estates owing tax will drop from about 1,100 to between 200 and 250.

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

From 1985 to 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 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 (33 in 2018) 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*, December 2016 and Minnesota Department of Revenue, *Minnesota Estate Tax Study* (2014) for more information.