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Minnesota Enacts Significant Changes to Minnesota Estate and Gift Tax Laws

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On May 23, 2013, Governor Dayton signed an Omnibus Tax Bill into law that may have a significant impact on clients who reside in Minnesota and those who reside outside of Minnesota but own property located in Minnesota. Minnesota will now become the second state after Connecticut to impose a gift tax at this time. The new law also imposes a Minnesota estate tax for all property located in Minnesota held in pass-through entities. The following are some of the key provisions of the law:

1. **Imposition of Gift Tax.** A Minnesota gift tax of 10 percent will be imposed on certain taxable gifts made by Minnesota residents and non-residents owning property located in Minnesota.

- Minnesota residents and non-residents will be subject to Minnesota gift tax on all transfers of real property located within Minnesota and transfers of tangible personal property that is customarily kept in Minnesota at the time the gift is executed. In addition, Minnesota residents will also be subject to Minnesota gift tax on transfers of intangible assets (e.g., cash, securities, business interests).
- Each individual has a lifetime $1,000,000 exemption from the Minnesota gift tax. Unlike the federal gift tax exemption, the Minnesota gift tax exemption is not indexed for inflation. The Minnesota gift tax only applies to transfers that are treated as taxable gifts for federal gift tax purposes. As a result, certain gifts that are not subject to the federal gift tax – including transfers falling within the annual exclusion ($14,000 in 2013), gifts to spouses, charitable gifts and certain transfers for educational or medical purposes – will not be subject to the Minnesota gift tax.
- **The Minnesota gift tax does not take effect until June 30, 2013. We anticipate that many clients will wish to make taxable gifts prior to June 30, 2013, in order to avoid the imposition of the Minnesota gift tax.** This may be particularly important for clients that have not yet taken advantage of their $5,000,000 federal gift, estate and generation-skipping transfer tax exemptions (indexed for inflation to $5,250,000 in 2013).

2. **Inclusion of Prior Gifts in Minnesota Taxable Estate**. Minnesota continues to have an estate tax on all Minnesota taxable estates that exceed $1,000,000, with a top state estate tax rate of 16 percent. Beginning in 2013, individuals who die resident in Minnesota or those who own property located in Minnesota will be required to include Minnesota taxable gifts made within three years of death in their Minnesota taxable estate.

3. **Entities Owning Real or Tangible Property Located in Minnesota Will Be Disregarded for Estate Tax Purposes.** Effective for individuals dying after December 31, 2012, the location of real or tangible personal property held in a pass-through entity (such as a limited liability company, S corporation or partnership) will be determined as though the entity does not exist for estate tax purposes. This means that property located in Minnesota held in pass-through entities will be subject to estate tax.

- Under prior law, a non-resident owner of an interest in a pass-through entity that owned real estate, inventory or equipment in Minnesota was not subject to Minnesota estate tax on that property. The new law appears to subject such property to Minnesota estate tax, even if the business owner or investor has no other connection to Minnesota and even if the business entity is organized and operated in another state.
- Some non-resident clients may have previously transferred Minnesota-sitused property to a pass-through entity in order to avoid the Minnesota estate tax. We anticipate that our clients will want to review whether such arrangements continue to be appropriate.
- The new law does not apply to Minnesota-sitused property owned by C corporations. As always, we expect that clients will want to consider whether a conversion in the type of entity they are using is appropriate for their business and overall tax exposure.
- The new law does not include a similar provision for Minnesota gift tax. After June 30, non-residents may be able to continue making gifts of interests in pass-through entities owning Minnesota-sitused property without the imposition of Minnesota gift tax. However, any such gifts made within three years of death will be included in the individual's Minnesota taxable estate. We anticipate that non-resident clients wanting to make transfers of Minnesota-sitused assets will want to do so as soon as possible in the event that the Minnesota gift tax provisions are modified to align with the new Minnesota estate tax provisions.

We expect many of our clients will want to review whether it would be appropriate to make additional gifts prior to June 30, 2013. If you would like to discuss how these changes to the Minnesota estate and gift tax laws affect you, please contact a member of Fredrikson & Byron's Trusts & Estates Group.