Changes to Minnesota Estate Tax: Non-Residents Now Subject to Minnesota Estate Tax

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Recent changes in Minnesota estate and gift tax law may have far-reaching implications for non-residents. Common estate planning techniques and recommendations for non-residents to maintain control of real and tangible property located in Minnesota now may provide little protection from Minnesota estate tax.

Prior to 2014, a non-resident of Minnesota who owned an interest in a pass-through entity that owned real property, tangible personal property, or equipment in Minnesota was not subject to Minnesota estate tax upon the death of the non-resident. The new law now subjects such property to possible Minnesota estate tax despite the non-resident having no connection – aside from an ownership interest in the entity – to the State of Minnesota. Moreover, a non-resident having an interest in a pass-through entity that owns real property, tangible personal property, or equipment in Minnesota may be subject to Minnesota estate tax even if the business entity is incorporated or organized and operated in another state.

Minnesota Estate Tax and Residency

Minnesota is one of only 19 states, along with the District of Columbia, that imposes a state death tax. In 2015, Minnesota increased an individual's exemption – meaning the amount one can leave at death without having a tax assessed – to $1.4 million. This exemption will increase to $1.6 million in 2016, $1.8 million in 2017, and eventually cap out at $2 million in 2018. The likelihood of tax at death, along with less than habitable winters, has many Minnesota residents permanently relocating elsewhere.

To be considered a non-resident of Minnesota, an individual must not be present for more than 183 days in Minnesota and the individual must intend to reside permanently outside of Minnesota. To establish such intent, the Minnesota Department of Revenue has an objective test in which 26 factors – including the location of financial institution, advisors, and place of worship – are evaluated to determine an individual's domicile. Establishing the lack of physical presence in Minnesota is a far easier task than satisfying the Department of Revenue's residency intent factors. Not one of the 26 factors is determinative over the other factors; however, some of the factors provide stronger evidence in establishing an individual's intent to make some other place – outside of Minnesota – his or her home.

Prior to the changes in 2013 and 2014, one of the main concerns in estate planning for a non-resident was ensuring that the individual satisfied the Minnesota Department of Revenue's residency test, thereby putting his or her, most likely, outside the reach of the Minnesota Department of Revenue and Minnesota estate tax. Unfortunately for some non-residents, this first step does not provide absolute protection.

Changes in Definitions Broaden Scope of Tax

The possible imposition of Minnesota estate tax on a non-resident who owns seasonal real property in Minnesota – such as a cabin or lake home – is not a farfetched concept. Similarly, exposure to Minnesota estate tax if a non-resident maintained significant tangible personal property in the state is not a shocking revelation. What may come as a shock to many non-residents is the possibility of Minnesota death tax if the non-resident has an ownership interest in a pass-through entity with assets that include real or tangible personal property in Minnesota, or if such ownership interest was gifted within three years of death.

The 2013 and 2014 amendments to the Minnesota estate tax law focuses on broadening definitions of "Minnesota adjustable taxable estate" and "situs of intangible personal property" to expand to individuals both within and outside state lines. For instance, an individual's adjusted taxable estate now includes taxable gifts within three years of the decedent's death. This provision does not apply to annual exclusion gifts – currently $14,000 – made to individuals. Any gifts made over and above this amount, and occurring within three years of death, are brought back into the estate for calculation of Minnesota estate tax.

In addition to the claw back of gifts made within three years of death, the other significant change came to the definition of "situs of intangible personal property." The definition includes ownership interests by residents and, now, non-residents in pass-through entities that owned real or tangible personal property located in Minnesota at the time of death. A pass-through entity can include:

- a corporation electing to be treated as an S-corporation for tax purposes;
- a single-member limited liability company;
- a multi-member LLC or other entity taxed as a partnership; or
- a trust, to the extent the property is includable in the decedent's federal gross estate.

The new law, in effect, removes the pass-through entity from the equation and treats the property – either real or personal – as being personally owned by the decedent. If the decedent shared ownership of the pass-through entity with other individuals, then the decedent's ownership of the property is proportional to the decedent's capital ownership share of the pass-through entity.

The impact of these changes is likely to be far-reaching given traditional estate planning vehicles for non-residents of Minnesota, including establishing a family limited partnership or limited liability company to hold and manage a family cabin, farm, or lake home. For example, Minnesota residents would until now establish a pass-through entity to allow mom or dad to maintain control and determine if and when interests in the entity could be transferred or gifted, while at the same time

reducing their overall gross estate. Under the new law, such traditional estate planning is no longer effective.

Next Steps

Whenever there is a significant change affecting an estate plan or the transfer of wealth, it is always advisable to review one's current estate plan to ensure it remains effective. There are still some, though not as many, options available to non-residents. Specifically, the law does not apply to Minnesota-sitused property owned by a C-corporation. It may be possible to convert the pass-through entity currently holding property into a C-corporation, although one should carefully consider the tax implications before any such conversion. Also, non-residents may decide to gift interests in a pass-through entity earlier than at death – although hopefully living at least three years following the gift.

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Practice Areas

Estate Planning and Wealth Preservation