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Legal Briefs from the Attorneys of
Mackall, Crouse & Moore, PLC

ESTATE PLANNING

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2011 EXPANSION OF MINNESOTA ESTATE TAX EXEMPTION

Background. Despite the impasse in achieving a Minnesota state budget deal, the omnibus tax bill that was finally approved by the Governor and the Legislature provides an expanded Minnesota estate tax exemption for the estates of some decedents who die after June 30, 2011. At the federal level, the 2010 Tax Relief Act signed by the President on December 17, 2010, provided a \$5 million federal estate tax exemption for decedents dying in 2011 and 2012. Although Minnesota's basic exemption remains at \$1 million, Minnesota has now adopted a \$5 million total exemption for estates that include a "qualified small business property" or "qualified farm property." After June 30, 2011, all estates continue to qualify for a \$1 million Minnesota exemption, with an additional \$4 million exemption available for estates that include a small business or farm property that meets specific criteria.

Qualified Small Business Property. The small business property must satisfy all of the following requirements:

1. Its value is included in the federal adjusted taxable estate;
2. It consists of a trade or business property (or shares of stock or other ownership interests that are not publicly traded) and the decedent or spouse materially participated in the operation of the business;
3. It had gross annual sales for the most recent taxable year of \$10 million or less;
4. Any cash or equivalents are deducted from the value of the business (for purposes of determining the amount of exemption to apply);
5. The decedent owned the business for the three-year period before the date of death;
6. A family member continuously uses the property for three years after the date of death; and

7. The estate and the qualified heir agree to pay a recapture tax if a family member fails to satisfy the requirement to use the property for the three-year period.

Qualified Farm Property. The farm property must satisfy all of the following requirements:

1. Its value is included in the federal adjusted taxable estate;
2. It consists of a farm, as defined by Minnesota law, and was classified as the decedent's agricultural homestead for property tax purposes;
3. The decedent continuously owned the property for the three-year period before the date of death;
4. A family member continuously uses the property for three years after the date of death; and
5. The estate and the qualified heir agree to pay a recapture tax if a family member fails to satisfy the requirement to use the property for the three-year period.

Recapture Tax. A recapture tax is assessed if the qualified heir disposes of the property, except by transferring it to a family member, or if a family member fails to satisfy the three-year use requirement. The tax equals 16% of the value of the exclusion and is due six months after the property is disposed of or the qualifying use ceases. A "family member" means a decedent's spouse, ancestor, lineal descendent or spouse of a lineal descendent. "Qualified heir" is a family member who acquired the farm or small business property and agreed to continue using the property for the same purpose or to pay recapture tax.

Estate Tax Study. The omnibus tax bill also requires the Minnesota Commissioner of Revenue to prepare an estate tax study and to report to the Legislature by February 1, 2012. This study is to evaluate the tax using standard tax policy methods and to consider revenue neutral ways to restructure or replace the tax, such as inheritance tax, complementary gift tax and other options. The Commissioner is directed to consult with the probate and estate tax section of the Minnesota State Bar Association in conducting this study.

- Scott M. Nelson, Esq.

INCREASED LIFETIME GIFT TAX EXEMPTION – ONCE IN A LIFETIME OPPORTUNITY?

Under the 2010 Tax Relief Act signed by President Obama late last year, a two year window of opportunity exists for substantially increased gift transactions. As recently as 2010, individuals could only gift up to \$1 Million of assets through non-spousal transfers to other individuals during their lifetime without paying gift tax. Any amount of lifetime gifting in excess of \$1 Million resulted in the assessment of a gift tax which could be payable at rates as high as 55%. As a result of the recent “unification” of the estate tax, gift tax and generation skipping transfer tax exemption amounts all at \$5 Million, Congress has created an opportunity for individuals to gift up to \$5 Million. This gifting exemption can be “doubled up” for married couples who can utilize this gifting strategy for up to \$10 Million of assets. Of course, Congress did not provide for this opportunity to exist forever. The current expiration date for utilization of the \$5 Million gift tax exemption amount is December 31, 2012. Residents of the State of Minnesota also have a unique opportunity in that Minnesota currently has no separate gift tax law, and gifts are not currently addressed in the Minnesota estate tax calculation. The Minnesota law passed recently, however, does provide for funds for the Department of Revenue to study this issue. So what has been commonplace for estate and gift taxes, we can only say stay tuned for potential Minnesota estate and gift tax modifications.

There is also some uncertainty as to whether future changes in the federal law will result in an “add back” of these gifts for estate tax purposes. Any such “claw backs” under future law changes, however, would likely result in adjustments to the amount of the taxable estate of a deceased individual. As with the law which expired in 2010, uncertainty exists as to what Congress may do in the future with what it has created, but opportunities do exist for individuals to take advantage of the increased gift tax exemption amount for the next approximately 17 months.

Of course, gifting of significant assets by individuals does not come without other related issues, including Medical Assistance eligibility, creditor protection issues and loss of assets under the control of individuals. All of these issues should be taken into account when considering an overall gifting program as part of your individual estate plan. You should consult with one of the estate planning attorneys at Mackall, Crouse & Moore to provide you with an appropriate analysis of your individual situation.

- William J. O'Brien, Esq.

PORTABILITY OF ESTATE AND GIFT TAX EXEMPTIONS

A surviving spouse, who becomes a widow or widower after December 31, 2010, may elect to add to his or her own \$5 Million estate and gift tax exclusion amount any unused portion of his or her deceased spouse's exclusion. If, for example, the deceased spouse had made \$2 Million in taxable gifts before death, the surviving spouse may add the remaining \$3 Million exclusion amount to his or her own \$5 Million exclusion in calculating his or her future estate or gift tax liability.

Planning Considerations

If the couple's only reason for utilizing separate trusts in their existing estate plans was to take advantage of the maximum exemptions available for both of them, the inconvenience of establishing such trusts may no longer be necessary. A trust may still be appropriate for non-tax reasons, however, such as second marriages, special family circumstances, and the like.

Procedural Requisites

To take advantage of the deceased spouse's unused exclusion amount, an estate tax return for the deceased spouse's estate must be filed within the normal time limitations relating to such returns, and the surviving spouse must make an election on the return designating the amount to be added to his or her own exclusion. The filing and formal election are required even if the deceased spouse's taxable estate is less than \$5 Million. Moreover, the surviving spouse's calculation of the amount available under his or her election may be challenged by the IRS at the time of the surviving spouse's death. On remarriage and subsequent death of a new spouse, the survivor's exemption amount will be limited to the unused exemption amount available from the most recent spouse. For lifetime gifting purposes, a survivor of multiple marriages will not be allowed to accumulate multiple exclusions.

- Martin V. Aydelott, Esq.

RECENT ADDITION AT MCM IN THE ESTATE, TRUST AND ELDER LAW SECTION

As you may have noticed in a recent e-mail, Mackall, Crouse & Moore, PLC welcomes Scott M. Nelson to its Estate Planning Department. Scott has substantial experience in the areas of Estate & Trusts, Tax, Elder Law and Business & Corporate Law. We hope you will enjoy working with Scott to help assist you with your estate planning and elder law needs. He can be reached at 612-305-1429 or smn@mcmlaw.com

If you have any questions, please call one of the attorneys in our MCM Estate Planning group:

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