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ESTATE TAX PRIMER FOR MINNESOTANS

Background

We all understand that our government levies taxes on its constituents to fund its services and governance. But there are several types of taxes. The tax most of us encounter everyday is the sales tax. A sale of goods is a time when our governors see it fit to tax us. Perhaps the most famous tax is the income tax – the transfer of money from employer to employee, from borrower to lender (interest) are two common forms of income. Each year, income earners file a return with the IRS to determine how much they owe in light of their level of income for the past year.

The Estate tax is a completely separate tax triggered by an individual's death. This passing of wealth from one person to another – often one generation to another – is currently taxed by our federal government and, in Minnesota and many other states, by the state government.

Current Status of Estate Tax Laws

But estate taxes are not triggered *every* time someone dies. This tax only applies if an estate exceeds a certain threshold amount. For the years 2011 and 2012, the federal estate tax exemption is \$5 million per person – any estate below this amount is not subject to the federal tax. The first dollar beyond \$5 million is. Minnesota Estate taxes kick in at a lower amount - \$1 million. While these are significant estate levels, they come up quickly once you consider what is considered in calculating the number.

Calculating the size of an Estate

It is obvious that in calculating estate size, one would add the values of all assets – bank account balances, portfolio values, retirement account values, real estate equity, etc. However, we do not stop there. One must add the value of death benefits that would be payable upon one's death and add it to the total value of their assets.

This means a person with few assets and a \$1.5 million life insurance policy will have a taxable estate. Also, a family of modest means that owns significant land – perhaps a family farm – also have a sobering estate tax concern. In the last few years tillable farmland property in Minnesota [has skyrocketed to as much as \\$7,000 to \\$9,000 per acre](#). That means that a modest-sized farm of 150 acres will almost certainly be subject to the Minnesota Estate Tax based on the value of the land alone! In short, despite the exemptions, estate taxes touch a fairly large number of estates.

Uncertainty in the Federal Estate Tax Laws

Back in 2001, a federal estate tax law progression began, setting a \$1 million exemption level. This exemption increased in size incrementally to its peak in 2009 of \$3.5 million per person. The 2001 law then proscribed an “unlimited exemption” for the year 2010 – in other words, no federal estate tax. Few believed that congress would allow the federal estate tax to go away – but it did. (By the way, [George Steinbrenner died that year](#) and the federal government missed out on more than half a billion dollars in tax revenue).

At the end of 2010, the original law was scheduled to “sunset,” or revert to the 2001 level of a \$1 million exemption and a 55% tax on each dollar beyond. Just days before Christmas, congress agreed to a federal estate tax exemption of \$5 million – for two years. And that is where we had been since January 1, 2011. At the end of 2012, Congress acted to set a more permanent estate tax law in place – an exemption a bit over \$5 million set to increase annually with inflation – \$5.35 million in 2014. Any federal tax would be in addition to the approximate 10% that Minnesota would levy.

Planning for Estate Taxes

There are several methods to employ in planning for estate taxes. Which method is most appropriate depends on several variables: estate size, your goals, willingness to give during one’s lifetime, etc. Between a married couple, however, the use of Revocable Living Trusts can quickly serve to double both state and federal exemptions. In other words, a couple can spend a few thousand dollars to shelter up to \$2 million – rather than \$1 million – in Minnesota. For a \$2 million estate, this is an estate tax saving of nearly \$100,000 in Minnesota alone!

If your estate approaches \$1 million, please consider consulting with a good attorney to learn more about your specific situation.