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DEPARTMENT
OF REVENUE

Qualified Farm Property Subtraction Report

Report Date: February 27, 2017

DEPARTMENT OF REVENUE

February 27, 2017

The Honorable Greg Davids
Chair, House Taxes Committee
585 State Office Building

The Honorable Paul Marquart
DFL Lead, House Taxes Committee
261 State Office Building

The Honorable Roger Chamberlain
Chair, Senate Tax Committee
3225 MN Senate Building

The Honorable Ann Rest
Ranking Minority Member
Senate Tax Committee
2217 MN Senate Building

To Members of the Legislature of the State of Minnesota:

I am pleased to present this report on the Qualified Farm Property Subtraction. The genesis for this report was the conversation during last year's legislative session about the Estate Tax – specifically, the definition of qualified farm property and its linkage to the property tax classification of the property in the three-year period after the death of the decedent.

This report provides background on the evolution of the law, property classification, and it identifies legislative options to consider, including the governor and department's recommendations.

We look forward to continuing the discussion of this important topic with you.

Sincerely,

Cynthia Bauerly
Commissioner

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DEPARTMENT OF REVENUE

Enactment

The Minnesota Qualified Farm Property Subtraction (QFPS) was enacted by the Legislature on July 19, 2011, and signed into law by Gov. Mark Dayton on July 20, 2011.[1]

The provision became effective for estates of decedents dying after June 30, 2011.

Prior to enactment, information about the legislation was presented to the House Tax Committee's Property and Local Tax Division on March 11, 2011, and the Senate Tax Committee on March 16, 2011.

The purpose of the legislation was to raise what is commonly referred to as the Estate Tax "exemption amount"[2] to $5 million for farmers and small business owners.

2011 Law – Criteria, Continuing Requirements, and Recapture Tax

The law allows the use of the subtraction for electing "qualified heirs" of decedents who inherit "qualified farm property." Under the 2011 statute, there were two definitional criteria to be a "qualified heir:"

1) The first requirement was that the heir be a family member within the meaning of the Internal Revenue Code (IRC), section 2032A(e)(2).[3]

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[1] See Minnesota Laws 2011, First Special Session, Chapter 7, Article 1, Section 7.

[2] "Exemption amount" is a term that courts and commentators use to refer to the threshold amount of property that an estate can own while remaining "exempt" from the federal Estate Tax under IRC, section 2010. Strictly speaking, the amount is established by providing a unified credit against the federal estate and gift taxes. In 2011, the unified credit was set such that the "exemption amount" was $5 million. See IRC. section 2010 (2011). Because the amount of the unified credit is indexed for inflation, it increases every year. The "exemption amount" for 2017 is set at $5.49 million.

The phrase "exemption amount" is also used to refer to the threshold amount of property that an estate can own before triggering the Minnesota Estate Tax. This amount can more accurately be referred to as the estate's "zero bracket amount" for the purposes of the Minnesota Estate Tax, but the terms are interchangeable. The Minnesota zero bracket amount for estates of decedents dying in 2017 is $1.8 million. That amount is set to increase to $2 million for estates of decedents dying after December 31, 2017.

[3] The requirement that a qualified heir be a family member remains in effect under current law. IRC, section 2032A(e)(2), defines "family member" as one of the following:

A. an ancestor of such individual
B. the spouse of such individual
C. a lineal descendant of such individual, of such individual's spouse, or of a parent of such individual
D. the spouse of any lineal descendant described in subparagraph (C)

2) The second requirement was that the family member "continuously use the property in the operation of the trade or business for three years following the date of death of the decedent."[4] A qualified heir who did not meet this requirement during the three-year period would not qualify and would become subject to a Recapture Tax.

Qualified Farm Property

The term "qualified farm property" was defined using five criteria:

1) The value of the property was included in the federal adjusted taxable estate.

2) The property consists of a farm meeting the requirements of M.S. 500.24, and was classified for property tax purposes as the homestead of the decedent or the decedent's spouse (or both) under M.S. 273.124, and as class 2a property under M.S. 273.13, subd. 23.

3) The decedent continuously owned the property for the three-year period ending on the date of death of the decedent.

4) A family member continuously uses the property in the operation of the trade or business for three years following the date of death of the decedent.

5) The estate and the qualified heir elect to treat the property as qualified farm property and agree, in a form prescribed by the commissioner, to pay the Recapture Tax under M.S. 291.03, subd.11, if applicable.[5]

The 2011 law required that the property be classified as 2a for property tax purposes upon the death of the decedent, but this requirement did not continue after death. Instead, the qualified heir was required to use the property in the operation of "the trade or business" that had "consisted of a farm meeting the requirements of M.S. 500.24" at the death of the decedent.

M.S. 500.24 restricts the types of business entities that are allowed to engage in farming or own agricultural lands in Minnesota. However, M.S. 500.24 does not define the word "farm"[6] or provide a specific set of criteria to establish what constitutes a farm.

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[4] As detailed further below, the use of the phrase "the trade or business" in this sentence was later criticized as too vague. However, because of the definition of "qualified farm property," it was clear that the trade or business was required to be of an agricultural nature.

[5] M.S. 291.03, subd. 10 and subd. 11 (2011).

[6] The statute – M.S. 500.24, subd. 2(a) – defines "farming" as follows: "Farming" means the production of (1) agricultural products; (2) livestock or livestock products; (3) milk or milk products; or (4) fruit or other horticultural products. It does not include the processing, refining, or packaging of said products, nor the provision of spraying or harvesting services by a processor or distributor of farm products. It does not include the production of timber or forest products, the production of poultry or poultry products, or the feeding and caring for livestock that are delivered to a corporation for slaughter or processing for up to 20 days before slaughter or processing.

Accordingly, the 2011 version of the law was not specific in its definition of the word “farm,” in that it required that a qualified heir continue “the trade or business,” but did not clearly define what the trade or business was required to be.

Recapture Tax

The 2011 law required a “recapture tax” if, one of the following occurred during the three years following the decedent’s death:

1) The heir became disqualified for failing to use the property in the operation of the trade or business.
2) The heir disposed of (by sale or otherwise) the property before death to a non-family member.

M.S. 291.03, subd. 11 (2011) provides specifically:

> (a) If, within three years after the decedent’s death and before the death of the qualified heir, the qualified heir disposes of any interest in the qualified property, other than by a disposition to a family member, or a family member ceases to use the qualified property which was acquired or passed from the decedent, an additional estate tax is imposed on the property.
>
> (b) The amount of the additional tax equals the amount of the exclusion claimed by the estate under subdivision 8, paragraph (d), multiplied by 16 percent.
>
> (c) The additional tax under this subdivision is due on the day which is six months after the date of the disposition or cessation in paragraph (a).

The tax is assessed at the highest marginal rate for estates and applies to 100 percent of the claimed exclusion amount regardless of circumstance. As a result, in situations where the Recapture Tax is triggered, estates pay liabilities in excess of what would have been due had the subtraction not been utilized.

2012-2013 Amendments

The QFPS was the subject of hearings in both the House and Senate tax committees in 2012. The House Tax Committee took up discussion of the provision on March 20, 2012, with the Senate following on March 27, 2012.

The department presented information to each committee, offering technical amendments to improve the law.

The amendments were prepared in consultation with legislative staff from the House Research Department and Senate Counsel, as well as the Minnesota State Bar Association, the Minnesota Farm Bureau, the Minnesota Farmers Union, and the National Federation of Small Business.

The technical amendments offered made the following changes with regard to the QFPS:[7]

1) Clarified that property transferred via trust ownership was eligible for the subtraction.
2) The original law required that qualified farm property meet the requirements of M.S. 500.24. The department offered technical changes to ensure this cross reference was worded correctly, which is reflected in the current law.
3) The original law did not provide what specific type of activity qualified as continuing a particular "trade or business." Stake holders in the farm community expressed concern that qualified heirs, whose benefactor's had been leasing property to other growers, would not be able to engage in farming because the letter of the law may have required them to continue in the trade or business of leasing. The department offered legislation to address this issue by striking the requirement for continuing "the trade or business" and replacing it with a requirement that the property remain classified 2a under M.S. 273.13, subd. 23, throughout the three-year holding period.
4) The original law did not specify what property tax statement should be used in determining what portions of a decedent's property were classified as 2a at the time of death, thereby qualifying for the subtraction. The department offered legislation clarifying that property classified as 2a in the tax year of the decedent's death could qualify for the subtraction.
5) The department also offered procedural legislation providing for the filing of informational returns during the three-year holding period, and requiring that a specific Recapture Tax return be filed if a triggering event occurred.

The 2012 legislative session did not result in the passage of an Omnibus Tax Bill. However, the legislative changes discussed above were eventually enacted in 2013, as part of Minnesota Laws 2013, Regular Session, Chapter 143, Article 7. This legislation was passed by both houses of the Legislature on May 9, 2013, and was signed by Gov. Mark Dayton on May 23, 2013.

Program Utilization

According to the biannual Tax Expenditure Report published by Revenue's Tax Research Division, the QFPS program's projected utilization is as follows:

2016 Tax Expenditure Summary Projection

Tax Types

Estate	Detail	Year Enacted	FY 2016	FY 2017	FY 2018	FY 2019
Estate	Farm and Small Business Property	2011	21,400,000	19,800,000	17,600,000	17,400,000

[7] *Note:* Several other technical amendments were offered concerning the related Qualified Small Business Property subtraction. Those provisions are not discussed in this report.

The program's projected usage in dollars declines between 2017 and 2019 because of scheduled increases in Minnesota's estate tax exemption amount taking effect for those periods.[8]

Trust Planning

Some taxpayers have suggested the program's requirements should be changed. An area that is regularly the subject of constituent suggestions involves the agricultural homestead requirement under M.S. 291.03, subd. 10, para. 3. This provision requires qualified property, at the time of death, to be "classified as agricultural homestead, agricultural relative homestead, or special agricultural homestead under M.S. 273.124."

This requirement exists to ensure that the QFPS program is narrow in scope and accomplishes the policy goal as described by the Legislature in 2016:

> [E]nsuring that the use of the property by qualified heirs during the three-year period after the decedent's death is consistent with the purpose of limiting the subtraction to properties where its use continues that of the decedent without any material change in its use by the qualified heirs and its ownership is consistent with maintaining family ownership of the farm.[9]

The homestead requirement does not apply for the length of the three-year holding period; instead, it applies only at the time of the transfer.

Estate planning professionals have pointed out that the homestead requirement causes difficulties in planning, especially for estates that make use of trusts. Often, spouses prefer to separately own different tracts of real property – which might otherwise qualify as a single agricultural homestead – through two or more trusts where the other spouse is an after-death beneficiary.

Planners recommend this ownership structure in part to ensure that both spouses will be entitled to the maximum possible exemption amount allowed against the Estate Tax regardless of which spouse dies first.[10]

However, this structure also prevents the owners from having property classified as a "homestead" for property tax purposes because the law requires that the parcels share a common owner where noncontiguous parcels are involved.

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[8] See M.S. 291.03, subd. 1.

[9] See Minnesota Laws 2016, Regular Session, Chapter 188, Article 3, Section 28 (pocket vetoed June 21, 2016).

[10] *Note:* It is not possible to exclude property from the calculation of taxable estate using both the QFPS and a general exemption or spousal deduction. However, flexibility in estate planning is of considerable value, and estates often plan in a manner that will allow them to utilize whichever deduction is appropriate, given the circumstances at the time of death.

Reclassification of Real Property

Since the statute was amended in 2013, the department has encountered three common "reclassification issues." These common issues involve:

1) A reclassification of a dwelling area referred to as a 4bb reclassification.
2) A reclassification of some portion of vacant land referred to as a 2b reclassification.
3) Other reclassifications.

This section also discusses the calculation of the Recapture Tax.

4bb Reclassifications

The most common issues observed are "4bb reclassifications." This reclassification occurs when a qualified heir includes the value of a decedent's home, garage, or up to an acre of land on which the structures are situated, in the qualified farm property subtraction.

During the life of the decedent, the buildings and underlying land are allowed to have the same property tax classification as tillable farmland when they constitute the homestead of the owner – the 2a classification.[11] However, this classification is contingent upon the "homestead" status of the property. Accordingly, because it is common for qualified heirs inheriting property to reside elsewhere, it is also common for a decedent's house, garage, and one acre of land to be reclassified as 4bb property during the holding period.[12]

The department has not assessed tax following a 4bb reclassification prior to the publication of this report. The legislative record indicates that the "continued trade or business" requirement was abandoned by the Legislature in 2013. The Legislature did not wish to dictate the particular activity engaged in by a qualified heir so long as the property was used as a farm – it would be inconsistent with this intention to demand that qualified heirs reside in the homes of their deceased benefactors in order to qualify for the subtraction.[13]

The proposal in Appendix A of this report addresses 4bb reclassification scenarios.

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[11] See M.S. 273.13, subd. 23(f)(2).

[12] See M.S. 273.13, subd. 25(c), providing that "[c]lass 4bb includes non-homestead residential real estate containing one unit, other than seasonal residential recreational property, and a single family dwelling, garage, and surrounding one acre of property on a non-homestead farm classified under M.S. 273.13, subdivision 23, paragraph (b)."

[13] Legislation mitigating this issue was recommended in the department's Policy Bill in 2015, but was not enacted in that year due to lack of an Omnibus Tax Bill. The provision was included in the 2016 Omnibus Tax Bill, but that bill was also not enacted. See Minnesota Laws 2016, Regular Session, Chapter 188, Article 12, Section 23.

2b Reclassifications

Another common scenario involving property tax classification occurs when some portion of a farmland is reclassified from 2a to 2b – the classification for rural vacant land.[14] This can occur due to a cessation of farming activities, but it can also occur because some portion of the property was previously misclassified, or because the nature of some portion of the rural vacant land has changed over time.

In general, small portions of rural vacant land that are interspersed with active farm acreage are classified as 2a.[15] Over time, circumstances may change in such a way that it becomes reasonable for a property tax assessor to change the classification of some portion of a parcel near or between farm fields.

For example, where some portion of rural vacant land has developed significant tree growth over time, an assessor might determine that because of the tree growth, the property more reasonably fits the 2b definition, and it is no longer "unlikely to be able to be sold separately from the rest of the property" under M.S. 273, subd. 23(b).

If such a determination is made during the three-year holding period provided for under M.S. 291.03, subd. 11, the statute calls for the implementation of the Recapture Tax. Note that this is true even if the qualified heir has made no change in their use of the property in question.

This issue was addressed by a provision advocated for by the department last session that would have insulated heirs from the Recapture Tax when both of the following conditions apply:

1) less than 20 percent of their total acreage had been reclassified
2) the qualified heir had not substantially altered the property[16]

The proposal in Appendix A of this report addresses 2b reclassification scenarios.

Other Reclassifications

Since the 2016 legislative session, the department has learned of other situations involving a minor change in property tax classification that ultimately trigger the Recapture Tax under the

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[14] M.S. 273, subd. 23(c), provides that "[c]lass 2b rural vacant land consists of parcels of property, or portions thereof, that are unplatted real estate, rural in character and not used for agricultural purposes, including land used for growing trees for timber, lumber, and wood and wood products, that is not improved with a structure...

[15] See M.S. 273, subd. 23(b), providing that "[c]lass 2a property must also include any property that would otherwise be classified as 2b, but is interspersed with class 2a property, including but not limited to sloughs, wooded wind shelters, acreage abutting ditches, ravines, rock piles, land subject to a setback requirement, and other similar land that is impractical for the assessor to value separately from the rest of the property or that is unlikely to be able to be sold separately from the rest of the property."

[16] See Minnesota Laws 2016, Regular Session, Chapter 188, Article 12, Section 23.

current law. In some cases, property tax assessors will determine that a portion of a farm is "commercial property" instead of agricultural – a change from 2a to 3a. A property tax assessor might make this reclassification if they observe that a building on a farm is used to conduct commercial repair activities involving farm equipment.

This situation involves the same three inequitable circumstances discussed with regard to the other reclassification types discussed above:

1) The change in classification is minor compared to the total size of the farm.
2) The qualified heir has not significantly changed their use of the inherited property.
3) The tax consequences can be relatively severe compared to the benefit the estate received by using the QFPS.

In order to ensure equitable treatment of taxpayers who might be subject to such a change, and to ensure the statute works well in the future, the department recommends that legislation be adopted to address property tax reclassifications in general.

Impact of Reclassifications

The potential consequences of even small reclassifications of property are serious because of the way Recapture Tax is calculated under M.S. 291.03, subd. 11(b).

The statute does not call for a proportional share of the property to be subject to the tax – such as the value of the property that has been reclassified. Instead, it calls for the Recapture Tax to be imposed on all qualified property that was subject to the subtraction.[17]

In many cases, the amount of the Recapture Tax to be assessed exceeds the amount of tax reduced by use of the subtraction.[18]

[17]**Note:** This also includes the value of any property excluded from the value of taxable estate using the qualified small business property subtraction.

[18] This occurs in cases where a qualified heir claims the subtraction for property in excess of the amount necessary to eliminate the Estate Tax – a common occurrence. Additionally, property that is excluded from taxable estate through the use of the QFPS often would have been removed from taxable estate through the use of some other deduction but for the QFPS – the most common other deduction being the unlimited marital deduction under IRC, section 2056.

Taxpayers who have become subject to the Recapture Tax since its inception have often complained that this is unfair because they may have paid little to no tax if they had not used the subtraction.

MN DEPARTMENT OF REVENUE

Appendix A

Scope and Purpose

This appendix outlines and Gov. Mark Dayton and the Department of Revenue's previous recommendations about the Qualified Farm Property Subtraction (QFPS), and presents potential alternative methods that the Legislature could employ to accomplish its policy goals in that area.

This appendix is in response to the Legislature's request in Minnesota Laws 2016, Chapter 188, Article 3, Section 28, which was not enacted. Except for Proposal 1, the inclusion of a proposal does not represent an endorsement by Gov. Dayton or the Department of Revenue.

Proposal 1 – Adopt Gov. Mark Dayton and the Department of Revenue's Recommendations.

Adopting the recommendations found in the governor's 2017 Tax Bill and the department's 2015 and 2016 Policy Bill regarding eminent domain will provide a large number of estates closure and finality with regard to their recapture tax status.

Enacting these provisions will preclude the assessment of tax in all cases that the department is currently aware of involving a 4bb or 2b reclassification where the taxpayer has not changed his or her use of the property. This legislation does not address the concerns of taxpayers who may become subject to tax as the result of a classification change other than a 4bb or a 2b change.

This legislation also does not address the concerns of taxpayers wishing to utilize certain trust planning arrangements that prevent them from qualifying as an agricultural homestead under M.S. 273.124.

Enacting language:

> Sec. ___. Minnesota Statutes 2016, section 291.03, subdivision 11, is amended to read:
>
> Subd. 11. **Recapture tax.** (a) If, within three years after the decedent's death and before the death of the qualified heir, the qualified heir disposes of any interest in the qualified property, other than by a disposition to a family member, or a family member ceases to satisfy the requirement under subdivision 9, clause (7); or 10, clause (5), an additional estate tax is imposed on the property. In the case of a sole proprietor, if the qualified heir replaces qualified small business property excluded under subdivision 9 with similar property, then the qualified heir will not be treated as having disposed of an interest in the qualified property.
>
> (b) The amount of the additional tax equals the amount of the exclusion claimed by the estate under subdivision 8, paragraph (d), multiplied by 16 percent.
>
> (c) The additional tax under this subdivision is due on the day which is six months after the date of the disposition or cessation in paragraph (a).

(d) This subdivision shall not apply as a result of any of the following:

(1) a portion of qualified farm property consisting of less than one-fifth of the acreage of the property is reclassified as class 2b property under section 273.13, subdivision 23, and the qualified heir has not substantially altered the reclassified property during the three-year holding period;

(2) a portion of qualified farm property classified as 2a property at the death of the decedent pursuant to section 273.13, subdivision 23, paragraph (a), consisting of a residence, garage, and immediately surrounding one acre of land is reclassified as 4bb property during the three-year holding period, and the qualified heir has not substantially altered the property; or

(3) acquisition of title or possession of the qualified property by a federal, state, or local government unit, or any other entity with the power of eminent domain for a public purpose, as defined in section 117.025, subdivision 11, within the three-year holding period.

EFFECTIVE DATE. This section is effective retroactively for estates of decedents dying after June 30, 2011.

Alternative Method 1 – Create a Spousal Beneficiary Exception to the Homestead Requirement for Farmland Owned by Trustees.

Estates use “trust planning” for a large variety of reasons. Many estates that use “trust planning” as a tax minimization strategy do so in order to ensure that both spouses will receive the full benefit of the state and federal exemption amounts.

Under current law, some taxpayers are unable to implement such a trust arrangement and also take advantage of QFPS, because owning property separately in different trusts causes them to be ineligible for homestead status. The Legislature could offer relief in these circumstances by amending the statute to provide an exception to the homestead requirement for farmland owned by a trustee after the decedent’s death in cases where the decedent’s spouse has at least a lifetime interest in the property within the meaning of IRC, section 2056(b)(7).

Enacting Language:

Sec___. Minnesota Statutes 2016, Section 291.03, subdivision 10, is amended to read:

Subd. 10. Qualified farm property. Property satisfying all of the following requirements is qualified farm property:

(1) The value of the property was included in the federal adjusted taxable estate.

(2) The property consists of agricultural land and is owned by a person or entity that is either not subject to or is in compliance with section 500.24.

(3) For property taxes payable in the taxable year of the decedent's death, the property is classified as class 2a property under section 273.13, subdivision 23, and is classified as

agricultural homestead, agricultural relative homestead, or special agricultural homestead under section 273.124.

(a) the requirement that property be classified as agricultural homestead, agricultural relative homestead, or special agricultural homestead under section 273.124, shall not apply if the following conditions are satisfied:

(i) the property is owned by a trustee at the time of the decedent's death;

(ii) immediately following the decedent's death the decedent's spouse has a qualifying income interest in the property within the meaning of IRC § 2056(b)(7), or a superior interest; and

(iii) all other beneficiaries of the trust are family members.

(4) The decedent continuously owned the property, including property the decedent is deemed to own under sections 2036, 2037, and 2038 of the Internal Revenue Code, for the three-year period ending on the date of death of the decedent either by ownership of the agricultural land or pursuant to holding an interest in an entity that is not subject to or is in compliance with section 500.24.

(5) The property is classified for property tax purposes as class 2a property under section 273.13, subdivision 23, for three years following the date of death of the decedent.

(6) The estate and the qualified heir elect to treat the property as qualified farm property and agree, in a form prescribed by the commissioner, to pay the recapture tax under subdivision 11, if applicable.

EFFECTIVE DATE. This section is effective retroactively for the estates of decedents dying after 12/31/2016.

Alternative Method 2 – Reclassification of up to 1/5 with no Substantial Change in Activity.

This proposal would prevent the triggering of the Recapture Tax in cases where less than 20 percent of qualified farm property lost its 2a classification as long as the qualified heir had not substantially changed their use of the property.

This approach allows flexibility for property tax assessors while also ensuring that:

1) Large amounts of non-farm property improperly classified will be subject to recapture.
2) Qualified heirs will continue to use inherited property for agricultural purposes during the three-year holding period

Enacting language:

Sec. ___. Minnesota Statutes 2016, section 291.03, subdivision 11, is amended to read:

Subd. 11. **Recapture tax.** (a) If, within three years after the decedent's death and before the death of the qualified heir, the qualified heir disposes of any interest in the qualified

property, other than by a disposition to a family member, or a family member ceases to satisfy the requirement under subdivision 9, clause (7); or 10, clause (5), an additional estate tax is imposed on the property. In the case of a sole proprietor, if the qualified heir replaces qualified small business property excluded under subdivision 9 with similar property, then the qualified heir will not be treated as having disposed of an interest in the qualified property.

(b) The amount of the additional tax equals the amount of the exclusion claimed by the estate under subdivision 8, paragraph (d), multiplied by 16 percent.

(c) The additional tax under this subdivision is due on the day which is six months after the date of the disposition or cessation in paragraph (a).

(d) This subdivision shall not apply as a result of any of the following:

(1) a portion of qualified farm property consisting of less than one-fifth of the total acreage is reclassified under section 273.13 during the three years following the death of the decedent, and the qualified heir has not substantially altered their use of the reclassified property during the three-year period.

EFFECTIVE DATE. This section is effective retroactively for estates of decedents dying after June 30, 2011.

Alternative Method 3 – Prorate the Recapture Tax.

The Recapture Tax is designed in a broad manner, in that it applies to all "qualified property" once triggered. This change would make the tax a more conventional "recapture" in that it would more narrowly recover the value of a benefit conferred to the taxpayer if they failed to continue qualifying for the required three-year period.

Enacting language:

Sec.___ Minnesota Statutes 2016, section 291.03, subdivision 11, is amended to read:

Subd. 11. Recapture tax. (a) If, within three years after the decedent's death and before the death of the qualified heir, the qualified heir disposes of any interest in the qualified property, other than by a disposition to a family member, or a family member ceases to satisfy the requirement under subdivision 9, clause (7); or 10, clause (5), an additional estate tax is imposed on the property. In the case of a sole proprietor, if the qualified heir replaces qualified small business property excluded under subdivision 9 with similar property, then the qualified heir will not be treated as having disposed of an interest in the qualified property.

(b) The amount of the additional tax equals ~~the amount~~ the value of the property becoming disqualified under paragraph (a) because it has been sold to a non-family member, or fails to continue qualifying under subdivision 9, clause (7); or 10, clause (5) ~~of the exclusion claimed by the estate under subdivision 8, paragraph (d)~~, multiplied by 16 percent.

(c) The additional tax under this subdivision is due on the day which is six months after the date of the disposition or cessation in paragraph (a).

EFFECTIVE DATE. This section is effective retroactively for the estates of decedents dying after 12/31/2016.

Alternative Method 4 – Prorate the Recapture Tax and Extend the Holding Period.

Same as above, but with an extended holding period to strengthen the incentive for family members utilizing the subtraction to retain their property and continue farming. The period could be extended to 5 years or 10 years. The analogous federal special valuation program provided for under IRC, section 2032A, has a prorated recapture with a 10-year holding period.

Sec.___ Minnesota Statutes 291.03, subdivision 10 and 11 are amended to read:

Subd. 11. Recapture tax. (a) If, within (five/ten) ~~three~~ years after the decedent's death and before the death of the qualified heir, the qualified heir disposes of any interest in the qualified property, other than by a disposition to a family member, or a family member ceases to satisfy the requirement under subdivision 9, clause (7); or 10, clause (5), an additional estate tax is imposed on the property. In the case of a sole proprietor, if the qualified heir replaces qualified small business property excluded under subdivision 9 with similar property, then the qualified heir will not be treated as having disposed of an interest in the qualified property.

(b) The amount of the additional tax equals ~~the amount~~ the value of the property becoming disqualified under paragraph (a) because it has been sold, or fails to continue qualifying under subdivision 9, clause (7); or 10, clause (5) ~~of the exclusion claimed by the estate under subdivision 8, paragraph (d)~~, multiplied by 16 percent.

(c) The additional tax under this subdivision is due on the day which is six months after the date of the disposition or cessation in paragraph (a).

EFFECTIVE DATE. This section is effective retroactively for the estates of decedents dying after 12/31/2016.