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IS THE IRS ON THE NAUGHTY OR NICE LIST?

It is that time of year again. No, not the time we all start thinking about our January workout schedule (my mother's banana bread is worth every step on that treadmill). It is the time when the IRS releases the amount you can pass estate tax free upon your death (the Unified Credit Against Estate Tax) and the amount you can pass to any person gift tax free (Annual Exclusion).

As we sit around with our loved ones this holiday season, many of us will wonder what will happen to our family, our business, or our farm when we pass away. How much will they have to pay in taxes to keep the doors open? Will they have to sell land to pay the estate tax? How much can I gift my children next year without paying Uncle Sam his share?

How is the estate tax calculated? The IRS sets an amount every year that you may pass estate tax free upon your death. Whatever that amount is the year you die is the amount you may pass to your loved ones without paying Uncle Sam. Imagine everything you own fitting in one bucket, what is the value of that bucket? If the value of your bucket exceeds the amount you are allowed to pass estate tax free, then your estate will incur a 40% federal estate tax on the amount that is spilling over.



Further, if you tried to give some assets in your bucket away during life and those assets exceeding the amount you were allowed to gift, the IRS will shrink your bucket resulting in a higher tax.

Is it really that simple? No. For those wanting a more technical explanation, keep reading (otherwise flip to the back). The Federal Estate Tax is a tax on your right to transfer property upon your death. The value of your estate for federal estate tax purposes is determined by taking your Gross Estate, minus any deductions, plus any lifetime taxable gifts. Your Gross Estate includes the fair market value of all of your property (cash, securities, real estate, life insurance, annuities, business interests, and all other assets you own) as of your date of death.

EXEMPTIONS THROUGH HISTORY

In 1980, you could pass \$161,000 estate tax free. In 1990, you could pass \$600,000. In 2000, the exemption was \$675,000. Then we saw a jump. In 2005, it was \$1.5 million. In 2009, it was \$3.5 million. In 2010, it was unlimited. Then, in 2011, it was \$1 million. What does this mean? You need a plan that is flexible enough to maximize your exemptions no matter how naughty or nice the IRS is being.



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Your taxable estate is then determined by taking your Gross Estate minus any eligible deductions (mortgages, estate administration expenses, property passing to qualified charities, etc.). Then, the value of any lifetime gifts that exceeded the Annual Exclusion for Gifts (the amount you can gift to any person gift tax free) in the year the gift was made is added to your Taxable Estate. If the value of your Taxable Estate exceeds the unified credit amount, then that amount in excess will incur a 40% federal estate tax.

DID THE IRS MAKE THE NAUGHTY OR NICE LIST?

Santa kept the IRS on the NICE list this year. Yet again, we are seeing one of the highest exemptions we have ever seen in most of our lifetimes. The Unified Credit Against Estate Tax (the amount you can pass estate tax free upon your death) is \$11,580,000 per person in 2020. The Annual Exclusion for Gifts (the amount you can pass estate tax free) is still \$15,000 per person in 2020. No change from last year.

2020 Exemptions
Estate Tax = \$11,580,000
Gift Tax = \$15,000

Although the IRS made the Nice list this year, Santa has already warned us that 2025 could be drastically different. In 2025, the exemptions are already set to be cut in half. We hear the elves are already mining the coal.

What does that mean for this year? Eat your holiday cookies, enjoy the time with your loved ones, and feel confident and secure that your Harris Law & Co. estate plan will pass on your legacy and protect your family (just maybe not your taste in holiday cookies). If you do not have a will or trust or need to review one you put together ages ago, give us a call at 605-777-1772 for a free initial meeting (I may even have some of my mother’s prized banana bread). Happy Holidays!

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