THE 2025 TAX EXEMPTION SUNSET AND HOW IT MAY IMPACT HNW FAMILIES

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As the tax cuts and jobs act (TCJA) provisions approach expiration, it is crucial for individuals and married couples to reassess their estate plans. Starting in 2017, the TCJA significantly increased gift and estate tax exemptions, allowing for larger wealth transfers to occur without taxes. Without congressional reapproval, however, the exemptions will revert to pre-TCJA limits on January 1, 2026. To preserve the current high exemption amounts and safeguard their family's legacy, individuals should consider various estate planning techniques. By taking proactive steps now, individuals may minimize potential estate tax liabilities if the exemption limits decrease in 2026.

When the Tax Cuts and Jobs Act (TCJA) was passed by the 115th United States Congress in December 2017, one of its most significant provisions was a substantial increase in the gift and estate tax exemptions. This change allowed individuals and married couples to pass on larger amounts of wealth to their heirs without incurring estate or gift taxes. The previous exemption amount of $5.6 million was doubled to $11.2 million for individuals, or $22.4 million for married couples if combining their exemptions. Any assets exceeding these thresholds would be subject to a 40% estate tax upon the individual's or couple's death.

Understandably, following the passage of the TCJA, families with estates valued below the new exemption limits may have felt less urgency to engage in complex estate planning strategies. The new exemption amounts were set to remain in effect for several years, with annual increases indexed to inflation. As of 2023, the gift and estate tax exemption amounts stand at $12.92 million for individuals and $25.84 million for married couples.

However, as we approach the latter half of 2023, it is crucial to recognize that the TCJA's provisions are set to expire soon, necessitating a reevaluation of estate plans. The higher exemption limits enacted by the TCJA will sunset, and on January 1, 2026, the exemption amounts will revert to the pre-TCJA limits of $5 million for individuals and $10 million for married couples, adjusted for inflation.

Given this upcoming change, it is advisable for individuals and married couples to revisit their estate plans to take advantage of any current opportunities. By taking proactive steps now, it is possible to protect assets and minimize potential estate tax liabilities.

To accomplish this, families should consult with their estate planning attorney and family advisors to consider various estate planning techniques, such as:

Lifetime Gifting: Making regular below the annual gift tax exclusion to transfer wealth to heirs during life can help reduce the overall size of the taxable estate. By leveraging the current high exemption amounts, individuals can take advantage of tax-free gifting opportunities, potentially shielding a significant portion of their wealth from future estate taxes.

Irrevocable Trusts: Establishing irrevocable trusts can be an effective strategy for removing assets from one's taxable estate while still retaining some degree of control over the assets. By transferring assets into these trusts and utilizing their available lifetime exemption, individuals can lock in the higher exemption amounts now before they potentially decrease in 2026.

Family Limited Partnerships (FLPs) or Limited Liability Companies (LLCs): Creating FLPs or LLCs allows individuals to consolidate family assets and retain control while gifting or transferring ownership interests to family members. This can help facilitate the smooth transfer of wealth while utilizing the current higher exemption amounts.

Grantor Retained Annuity Trusts (GRATs): GRATs are estate planning tools that allow individuals to transfer assets to beneficiaries while retaining an annuity payment for a specified period of at least two years. GRATs are an effective way of transferring assets while using little, if any, of the grantor's lifetime exemption.

Charitable Planning: Engaging in philanthropic endeavors through charitable trusts or foundations can serve both personal and tax planning goals. Charitable planning can help individuals reduce their taxable estates while making a positive impact on their chosen charitable causes.

Regular Estate Plan Review: Regardless of the potential changes in exemption amounts, regular estate plan reviews are always advisable. Life circumstances, tax laws, and personal goals may evolve over time, necessitating updates to estate plans to ensure they remain aligned with one's wishes and objectives.

In conclusion, with the potential sunsetting of the higher exemption limits set by the TCJA, it is prudent for families to revisit estate plans and meet with their trusted team of advisors. Pendleton Square is ready to help meet your needs and reach your goals. With our experts in trust and estate administration, we will complement and align with your team of legal advisors.

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About the author:

Hugh Brown, Principal and Senior Trust Officer, serves families and advisors by delivering best-in-class trust and estate services. Pendleton Square Trust Company, LLC does not manage or custody assets and does not provide tax or legal advice.