The Looming Estate Tax Trap: What You Need to Know

On January 1, 2026, significant adjustments to the lifetime estate and gift tax exemptions are slated to take effect. These changes, which involve halving the current exemption, could cost small business owners millions in estate tax if not properly planned for. Understanding these upcoming adjustments and their potential impact is paramount for anyone navigating the complex terrain of estate taxation.

The 2017 Tax Cuts and Jobs Act nearly doubled the lifetime estate and gift tax exemption from its prior levels. For 2024, the exemption is $13.61 million per person and $27.22 million for a married couple. Set to expire at the end of 2025, this estate and gift tax exemption could decline to approximately $7.5 million per individual and $14.5 million for a married couple, depending on inflation.

The impending reduction in the estate and gift tax exemption may call for a reassessment of your estate planning strategies. Individuals with substantial estates who are seeking to optimize tax efficiency and preserve assets for future generations should reevaluate their approaches to wealth transfer now. Failure to appropriately plan for these changes could result in significantly higher tax liabilities and impact the realization of near-term objectives and intended legacies.

Potential strategies to leverage the current higher exemption thresholds while they remain in effect include implementing strategic gifting and wealth transfer initiatives, establishing trusts, family partnerships, or other vehicles for transferring assets that can facilitate the preservation of wealth and minimize tax liabilities.

An estate that includes a family business can introduce complexities to an overall estate plan. This planning process is a balancing act between removing assets from your estate and what are the most appropriate assets to remove. As a business owner, there are strategies that allow ownership transfer while retaining control of the business, such as forming a family limited partnership (FLP) or family limited liability company (FLLC). Both corporate entities can allow the transfer of wealth between generations and give limited liability protection to partnership assets from the claims of creditors and divorcing spouses.

In addition to proactive planning, individuals should also consider the broader implications of the impending changes on their overall financial and estate planning goals and objectives. Reviewing beneficiary designations, updating estate plans, and conducting comprehensive wealth audits are among the critical process steps to ensuring alignment with current objectives and regulatory realities.

By maintaining flexibility and adaptability in their planning approach, individuals can work to mitigate risks and capitalize on potential opportunities presented by the shifting tax environment. Keep in mind that the thoughts presented are merely examples of potential strategies an individual or businessowner should consider. Please speak with your financial planner and your other trusted advisors about what options may be appropriate for your situation and goals.