Insights

Chasing the "Worm" – Act Now to Use the Federal Gift/Estate Tax Exemption

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It is not too early for individuals and families to start preparing for reductions to the Federal gift and estate tax exemption equivalent ("FET Exemption") that become effective on January 1, 2026.

The FET Exemption has increased through annual inflation adjustment, as well as an effective doubling under the Tax Cuts and Jobs Act of 2017 ("TCJA"). The current FET Exemption is now $12.92 million per individual or $25.84 million per married couple. Any amount over the FET Exemption is subject to a 40% tax rate. The FET Exemption is used for transfers during an individual's life for gifts above $17,000 each year to any individual (the "Annual Exclusion") or any transfers due to that individual's death.

Under the TCJA, the doubling of the FET Exemption will expire on December 31, 2025, unless Congress proactively passes new legislation. Absent such legislation, the FET Exemption will *decrease* to 2018 levels, with experts predicting that the FET Exemption will be around $7 million per individual or $14 million per married couple on January 1, 2026. Given the current political divisions, extension of the TCJA is uncertain, at best. Absent legislation, any amount of the FET Exemption that is currently available but remains unused when reduced on January 1, 2026 will be "lost." At that time, assets above the downward adjusted FET Exemption levels ($7 million/$14 million) will be subjected to the 40% tax rate.

To illustrate the ramifications, consider a married couple with a net worth of $30 million. If both individuals die in 2023 the couple would pay an estimated federal estate tax of $1.66 million (assuming no deductions and no gifts made during life) ($30 million - $25.84 million = $4.16 million x 40% = $1.66 million). Contrast that to the same couple dying in 2026 paying an estimated amount of $6.4 million in federal estate tax (assuming no deductions and no gifts made during their lifetimes) ($30 million - $14 million = $16 million x 40% = $6.4 million). For this couple, the consequence of doing nothing results in a tax increase of $4.74 million.

Potential tax liability is not always a concern for some individuals or families. However, for those who want to plan to avoid the effect of a decreased FET Exemption, several planning options can be considered for implementation before December 31, 2025. With the Annual Exclusion at $17,000, a married couple can give up to $34,000, each year, to any individual. Individuals and families can utilize gift strategies now to decrease the value of their taxable estates and remove appreciation on those assets. Those that own assets which might significantly appreciate over time (i.e. real estate, farm ground, or closely-held business interests) can make large gifts of those assets now up to their current FET Exemption through outright gifts or specially-designed, irrevocable trusts. By making large gifts now, the value of the gross taxable estate is reduced, the FET Exemption can be used before it decreases, and, again, future appreciation of those assets is removed from the taxable estate.

Individuals should be comfortable utilizing the larger FET Exemption now, without fear that gifts will be taxable later on when the FET Exemption decreases. The Treasury Department has issued a ruling stating it will not “clawback” taxable gifts into an estate if the FET Exemption reverts to pre-2018 levels. Thus, if an individual or family make large, lifetime gifts now up to the current FET Exemption ($12.92 million per individual/$25.84 million per married couple), the Federal government will not attempt to pull back the difference in exemption amounts ($5.92 million per individual or $11.84 million per married couple) into their taxable estates when they later die. Those individuals and families would be taking advantage of the additional exemption amounts now that they may never see again.

Importantly, this article has discussed Federal gift and estate tax implications only. Every state has different laws related to state inheritance or death taxes which also need to be considered, especially if an individual or family is transient and living across multiple states. Notably, Indiana does not have any inheritance or death taxes.

Individuals or families that currently have taxable estates should engage in gift and tax planning now. Even those whose net worth is between $7 million to $14 million should start thinking about their options. While such families do not have taxable estates now, they will in 2026. Planning and implementing early minimizes the risk of adviser availability as December 31, 2025 draws near. Advisors will likely become overwhelmed with many clients wanting to wait until the last minute to make gifts to take advantage of the current FET Exemption. At some point, it might be “too late” for the advisors to assist.

As the saying goes, “the early bird gets the worm.” In this situation, the “worm” is the current FET Exemption that is at an all-time high and can be used to realize significant tax savings. Contact your team of advisors to discuss your estate and tax planning now before that “worm” disappears in 2026.

If you or your business needs assistance with developing or implementing a gifting strategy, please contact **Rodney S. Retzner**, **Micah J. Nichols**, or any member of our **Estate Planning and Personal Services Practice**.

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