Wealth & Investment Management

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Revisit your estate plan in light of potential tax changes

Planning for the sunset of the Tax Cuts and Jobs Act

Key takeaways:

- *This publication addresses the potential impact of the upcoming expiration of the Tax Cuts and Jobs Act (TCJA), which will affect many taxpayers across various levels of wealth and income.*
- *The expiration of the TCJA may have a negative impact on certain taxpayers, especially those with large estates and those in higher income tax brackets. Based on these changes, it is important to work with your financial, legal, and tax advisors to make well-informed and thoughtful decisions.*

Sweeping changes were enacted with the passage of the Tax Cuts and Jobs Act (TCJA) in 2017. However, certain tax provisions of the TCJA are set to expire after December 31, 2025. Unless Congress passes legislation extending the TCJA, these provisions will revert to their pre-TCJA status beginning in 2026.

There are several tax benefits of the TCJA, so the expiration or "sunset" could have negative financial impacts on certain taxpayers, particularly those with large taxable estates and those in higher income tax brackets. As a result, it is important to understand and plan for the potential effects of the sunset in advance. Adopting certain strategies could potentially reduce the negative impacts, and revisiting your plan might be warranted. Having early discussions with your financial, legal, and tax advisors to understand the potential impacts to your wealth plan is key.

2025 sunset — tax law changes

If the TCJA expires after 2025, here are some of the impacts:

1. **Gift, estate and GST tax exemptions.** The TCJA doubled the gift, estate and generation skipping transfer (GST) tax exemption amount from $5 million to $10 million starting in 2018. This amount is indexed for inflation and adjusted each year in January. In 2024, the amount of wealth that can be left to most beneficiaries during life or at death without gift, estate or GST tax being imposed is $13.61 million per person ($27.22 million for a married couple). Wealth transferred to beneficiaries in excess of these exemption amounts is taxed at a 40% rate.

If the sunset occurs, the exemption amounts for 2026 will be cut in half, to about $7.25 million per person ($14.5 million for a married couple).

2. **Income tax rates.** The TCJA reduced individual income tax rates for most brackets of taxable income. If the sunset occurs, these tax rates will revert to their pre-TCJA levels. The table below is a comparison of the current income tax rates versus the post-sunset rates for a married couple filing jointly:

2024 Taxable income (Married filing jointly)	TCJA current marginal rate	Post-sunset marginal rate
Up to $23,200	10%	10%
Up to $94,300	12%	15%
Up to $201,050	22%	25%
Up to $383,900	24%	28%
Up to $487,450	32%	33%
Up to $731,200	35%	35%
Over $731,200	37%	39.6%

Note: Tax brackets are adjusted for inflation each year.

3. **Standard deductions.** To determine taxable income, taxpayers may utilize the standard deduction, or if eligible, they may itemize deductions. Typically, the larger number of the two is selected to be deducted from a taxpayer's adjusted gross income (AGI) in order to calculate taxable income.

The TCJA increased the standard deduction and eliminated the personal exemption for taxpayers. For 2024, the standard deduction is $29,200 (adjusted for inflation) for a married couple filing jointly. If sunset of the TCJA occurs, the standard deduction reverts to its 2017 level ($12,700, as adjusted for inflation) and the personal exemption will be reinstated.

4. **The alternative minimum tax (AMT).** The TCJA included provisions that dramatically lowered the number of taxpayers subject to the AMT, in part by providing for a higher AMT exemption and boosting the income level at which the exemption begins to phase out. If the sunset occurs, it has been estimated that the number of taxpayers affected by the AMT will rise from roughly 200,000 currently to 7.6 million in 2026.

5. **Mortgage interest deduction.** The TCJA limited the deduction allowed for interest paid on mortgage indebtedness. For mortgage debt incurred after December 15, 2017, taxpayers who itemize may deduct mortgage interest on the first $750,000 of debt for first or second homes. Post-sunset, the $750,000 limit will revert to the $1 million limit.

6. **State and local tax (SALT) deductions.** For itemizing taxpayers, the TCJA limited the amount deductible for state and local taxes paid — including income, sales, and property taxes — to $10,000. For taxpayers residing in high-tax states, this can be an economic detriment, albeit offset somewhat by the higher standard deduction. Post-sunset in 2026, this $10,000 limitation will end.

7. **Charitable giving deductions.** Taxpayers who itemize deductions may deduct amounts contributed to charities subject to certain income limits. Under the TCJA, the amount that can be deducted for cash gifts to public charities was increased to 60% of AGI. After the sunset, the deductible limit for such cash contributions reverts to 50%.

8. **Qualified business income deduction.** The TCJA added Section 199A of the Internal Revenue Code, which provides for a deduction of up to 20% of qualified business income (QBI) realized by sole proprietorships and pass-through tax entities such as partnerships, LLCs, and S corporations. This QBI deduction is subject to certain limitations and is only available to certain businesses. Upon sunset, this deduction will expire after 2025.

Ideas to prepare for upcoming changes

The sunsetting of the TCJA represents a significant change to the current law. In combination, the overall effects will vary widely among taxpayers. Several strategies are available to help minimize certain impacts of the sunset:

- Where appropriate, consider taking advantage of the higher gift tax exemptions by making large gifts, either outright or in trust, up to the full exemption amount, and make gifts next year when the exemption rises again. For gifts made in trust, consider utilizing the laws of a favorable trust jurisdiction, such as Delaware.
- If you are married, consider establishing one or two spousal lifetime access trusts (SLATs), which allow the grantor to be able to access the funds conveyed to a SLAT through the spouse as a beneficiary.
- If you have hard-to-value assets, such as real estate or closely held entities, that you would like to gift, engage a qualified firm to perform the valuation.
- Consider whether it makes sense to accelerate income prior to the sunset given the lower rates. For example, consider making a Roth conversion of your Traditional IRA now, when income tax brackets are lower.
- If accelerating income significantly increases your tax burden, consider establishing a donor-advised fund (DAF) to potentially reduce your taxable income.
- Review whether it makes sense to exercise employment-related stock options now given the potential changes in rates and the return of the AMT, which taxes certain options differently from the regular income tax.
- Evaluate ways to maximize the QBI deduction before it expires.

Some planning strategies may allow you to delay implementation of your gifting strategy until it is clear that the sunset of the current wealth transfer tax exemptions will actually occur, but you need to have your documents finalized well beforehand. Set up time with your financial, legal, and tax advisors to help you understand your options and determine what action steps may be appropriate for you.

Disclosures

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