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Dangerous Curve Ahead
The Upcoming Sunset of TCJA Provisions

Driving is a beloved part of American culture, whether cruising in a classic car, enjoying the open air in a convertible, or heading down the highway on a road trip. Of course, no matter where they're going, drivers should pay attention to the signs for information about the speed limit, the distance to the next major city, or which amenities are available at an upcoming stop. Most importantly, signs warn drivers about potential hazards. When highway drivers see a sign warning of "DANGEROUS CURVE AHEAD," they know they need to get ready to handle the changes in the road.

In 2017, Congress passed the Tax Cuts and Jobs Act (TCJA), which significantly changed Federal tax rules. Almost every facet of taxation featured some alteration, with the majority of taxpayers and businesses enjoying a reduced tax burden. However—and this is where the warning sign needs to be installed—most of the tax changes will end (or "sunset") on December 31, 2025. If Congress is unwilling or unable to take timely action to extend these provisions or make them permanent, unprepared taxpayers may find their estate and financial plans in significant "danger."

The "warning sign" is in front of us. We need to help our clients get ready to handle the coming changes to the estate and financial "highway." In this issue, we look at the key provisions of the TCJA that are scheduled to sunset and the impact that sunset will have on taxpayers, a few TCJA changes that will remain in place, and selected mitigation options for the sunsetting provisions.

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Individual Income Tax

Income Tax Rates and Tables

The TCJA made changes to the tax brackets related to individual income tax filers but did not change the number of individual income tax brackets. Overall, the rates were lowered, and the brackets were expanded.[1]

The TCJA sunset means a return to the 2017 brackets (although it is important to note that the IRS will adjust the individual dollar amounts in each tax bracket for inflation). Because the prior tax tables included additional brackets and brackets with higher taxes, this change may result in some taxpayers being subject to increased income taxes. This would close the window on people taking advantage of the current lower tax rates through tax planning techniques such as Roth conversions, income shifting, and capital gains harvesting. Encourage clients to seek professional advice and take steps now to mitigate the impact of any increase.

2017: SINGLE FILER

Top Tax Rate	Tax Bracket	Tax Liability
10%	$0 to $9,325	10% of taxable income
15%	$9,326 to $37,950	$932.50 plus 15% of the excess over $9,325
25%	$37,951 to $91,900	$5,226.25 plus 25% of the excess over $37,950
28%	$91,901 to $191,650	$18,713.75 plus 28% of the excess over $91,900
33%	$191,651 to $416,700	$46,643.75 plus 33% of the excess over $191,650
35%	$416,701 to $418,400	$120,910.25 plus 35% of the excess over $416,700
39.6%	$418,401+	$121,505.25 plus 39.6% of the excess over $418,400

2024: SINGLE FILER

Top Tax Rate	Tax Bracket	Tax Liability
10%	$0 to $11,600	10% of taxable income
12%	$11,601 to $47,150	$1,160 plus 12% of the excess over $11,600
22%	$47,151 to $100,525	$5,426 plus 22% of the excess over $47,150
24%	$100,526 to $191,950	$17,168.50 plus 24% of the excess over $100,525
32%	$191,951 to $243,725	$39,110.50 plus 32% of the excess over $191,950
35%	$243,726 to $609,350	$55,678.50 plus 35% of the excess over $243,725
37%	$609,351 +	$183,647.25 plus 37% of the excess over $609,350

Income Tax Deductions and Exemptions

For many taxpayers, the numerous changes to the deductions and exemptions under the TCJA had the most obvious annual impact.

1. Standard Deduction and Exemptions

The TCJA basically doubled the standard deduction:

	2017	2018*	2024**
Individuals	$6,350	$12,000	$14,600
Head of households	$9,350	$18,000	$21,900
Married couples filing jointly	$12,700	$24,000	$29,200

**TCJA amount   ** after annual inflation indexing*

In addition, prior to the TCJA, each taxpayer was allowed to claim a personal exemption for themselves, along with an exemption of $4,050 for each dependent.[2] The TCJA effectively repealed the personal exemption by setting it to zero.[3]

The sunset of the TCJA means taxpayers will have a smaller standard deduction but will benefit from the return of the personal exemption. Depending on the individual taxpayer, the reduced standard deduction may result in a higher federal tax burden.

2. Pease Limitation

The Pease limitation was a tax provision that limited deductions taken by high-income taxpayers, reducing them by 3% of the amount by which the taxpayer's income exceeded the thresholds set by the IRC. (In 2017, the phaseout began when a taxpayer's income exceeded $261,500, or $313,800 for married filing jointly.)[4] The reduction was capped at 80% of the total value of the taxpayer's deductions.

The TJCA repealed the Pease limitation, allowing high-income taxpayers to claim the full value of their deductions once again. After the sunset, the Pease limitation will return with inflation-adjusted thresholds.

3. SALT Deduction

Before the TCJA, the IRC allowed taxpayers to deduct from federal income taxes the full amount of state and local taxes paid (property taxes plus state income or sales taxes).[5] This unlimited deduction eased the burden of state taxes for taxpayers in states with high state tax rates.

Much to the dismay of taxpayers in many states, the TCJA capped SALT deductions at $10,000.[6] The impact was felt particularly strongly in California and Northeastern states like New York, where cumulative income taxes may approach 50% of a high-income taxpayer's income. See the potential impact in the example below:

Kim lives in an apartment in New York City and works on Wall Street. She is unmarried with no dependents. She had a good year in 2023, earning total compensation of $1,900,000 including wages and bonuses. She pays New York City income tax at 3.876%, New York State income tax at 9.65%, and federal income tax at 37%. Not considering other relevant deductions, her income tax burden looks like this:

Income	$1,900,000	
Federal Income Tax	$663,332	$174,238.25 plus 37% of the excess over $578,125
NY State Income Tax	$135,722	$108,359 plus 9.65% of the amount over $1,616,450
NY City Income Tax	$73,519	3.876% of the amount over $50,000, plus $1,813
Potential Income Tax	$872,573	Federal tax + State tax + City tax
Total SALT Tax	$209,241	State and city income tax with no property tax

The current SALT limitation significantly impacts Kim, as she can only deduct $10,000 in 2023—she cannot include the remaining $199,241 in her itemized deductions.

Like many other TCJA provisions, this cap will expire in 2025, bringing back the ability to fully deduct state and local taxes. Taxpayers like Kim will be pleased to again be able to deduct from federal income taxes the full amount of their state and city taxes.

4. Mortgage Interest Deduction

The 2017 IRC permitted taxpayers to take a mortgage interest deduction for the interest on a mortgage or a debt up to $1,000,000.[7] The TCJA kept this deduction but lowered the cap to $750,000 for mortgages entered into after December 14, 2017 (existing mortgages retain the higher cap, even if refinanced).[8] The TCJA eliminated the mortgage interest deduction for home equity loans.[9] Both of these changes are scheduled to sunset.

5. Charitable Deduction

While the TCJA did not change the overall itemized charitable income tax deduction, far fewer people are using it because the higher standard deduction under the TCJA made itemizing unnecessary. The sunset will lower the standard deduction and make itemizing more appealing again, meaning more people will actually claim the charitable deduction available for their gifts.

The TCJA did raise the cap on deductions for charitable gifts of cash from 50% of adjusted gross income (AGI) to 60%.[10] This positive change for donors is scheduled to sunset, returning the cap to 50% of AGI.

6. Miscellaneous Itemized Deductions

The TCJA removed the category of miscellaneous itemized deductions, which included items such as unreimbursed job expenses, investment expenses, tax preparation fees, and hobby expenses—items that were deductible to the extent they exceeded 2% of a taxpayer's AGI. The category will return after the sunset.

7. Deduction for Moving Expenses

The TCJA eliminated the deduction for moving expenses for everyone but certain members of the Armed Forces and their families.[11] The sunset will reinstate this deduction for all.

ABLE Accounts

The Achieving a Better Life Experience (ABLE) account provides a way to support individuals with special needs without the expense of creating a special needs trust (SNT).[12] The TCJA increased the limit on contributions to an ABLE account made by the beneficiary. Additionally, once the overall contribution limit is reached, the designated beneficiary can contribute an additional amount equal to the lesser of the federal poverty line for a single taxpayer or the individual's compensation for the respective tax year.[13] The TCJA also allowed funds to be rolled over from a designated beneficiary's 529 plan to an ABLE account set up for the same beneficiary or a family member.[14] The final regulations provide that rollovers from 529 plans, together with any contributions made to the designated beneficiary's ABLE account, cannot exceed the annual ABLE contribution limit. Upon the sunset of the TCJA, each of these opportunities will be eliminated—neither the additional contributions nor the rollover of 529 funds will be available to taxpayers.

Alternative Minimum Tax

While the TCJA repealed the corporate alternative minimum tax (AMT),[15] it kept the individual AMT with a higher exemption amount (indexed annually for inflation) that benefits taxpayers. With the sunset of the TCJA, the prior lower exemption amounts found in IRC §55(d)(1) will apply again (adjusted for inflation).

It is important to note that the Inflation Reduction Act created a new Corporate AMT (read more in the TCJA Permanent Changes section).

Estate & Gift Tax

Perhaps the most significant change that will come about from the sunset of the TCJA provisions is the reduction in the estate and gift tax exemptions. The TCJA doubled the exemption amount from $5 million to $10 million ($13.61 million in 2024 after annual inflation adjustments), meaning very few estates are currently subject to the estate tax.[16] However, if Congress does not act, the sunset of the TCJA would reduce the exemption by half for 2026 (in the $7 million range)—a change that will affect almost every taxpayer with a sizeable estate.

Example: Ed "Spot" Spotorski, aged 66 and single, owns an incredibly successful pet walking and day spa business named "See Spot Run." He is a resident of a state with no estate taxes. The pet spa, an LLC solely owned by Ed, is valued at $8.5 million dollars. If Ed dies in 2024, most of his estate would be exempt from estate tax. However, if he dies in 2026 and the estate tax exemption has reverted back to 2017 levels (adjusted for inflation), a large portion of his estate would be subject to the estate tax. Here is Ed's situation:

Assets

Business	$8,500,000
Residential home	$1,700,000
Vacation lake house	$850,000
Stocks and mutual funds	$6,153,000
Personal property	$189,000
Cash, checking, and savings	$358,000
TOTAL ASSETS	**$17,750,000**

Liabilities

Home mortgage	$0
Lake house mortgage	$167,000
Auto loans	$27,000
Credit card debt	$18,000
TOTAL LIABILITIES	**$212,000**

TOTAL ESTATE:

Assets	$17,750,000
Liabilities	$212,000
Total	$17,538,000
Estate Costs and Probate	$1,068,280*
Base Estate	**$16,469,720**

*Ed's estate planning team estimates his probate costs will be approximately 6%, and because he has a few unique funeral requests, his funeral costs will be around $16,000.

If Ed dies prior to December 31, 2025, his estate would benefit from the higher estate tax exemption amount in place under the TCJA, allowing him to transfer much of his estate free from Federal estate tax.

TCJA ESTATE:

Base estate	$16,469,720
Estate tax exemption amount (2024)	$13,610,000
Estate subject to tax	$2,859,720
Estate tax owed	**$1,089,688**

However, if Ed dies on January 1, 2026 (or thereafter), and the sunset has taken place, his estate would be affected by the much lower estate tax exemption amount of around $7 million.

SUNSET ESTATE:

Base estate	$16,469,720
Estimated exempt amount (assumed for comparison)	$7,000,000
Estate subject to tax	$9,469,720
Estate tax owed	**$3,733,688**

If the exemption amount is cut in half, the amount Ed must pay in estate taxes will more than triple! Another way to look at it is to compare how much of his estate will be subjected to the estate tax:

Sunset estate – amount subject to tax
$9,469,720

TCJA estate – amount subject to tax
$2,859,720

Additional amount of estate subject to tax
$6,610,000

A Note on Estate and Gift Transactions

Taxpayers raised the obvious question related to the use of the higher exemption amount once the TCJA expires: How will the IRS treat the use of the higher exemption amount, and will the IRS attempt to claw back amounts transferred using the higher exemption? In response, in November 2019, the IRS issued final regulations to account for the TCJA. In these regulations, the IRS allows taxpayers to compute estate taxes using the higher of the basic exclusion amount (BEA) in effect during the taxpayer's lifetime.[17] The IRS noted:

> The TCJA temporarily increased the BEA from $5 million to $10 million for tax years 2018 through 2025, with both dollar amounts adjusted for inflation. For 2019, the inflation-adjusted BEA is $11.4 million. In 2026, the BEA will revert to the 2017 level of $5 million as adjusted for inflation.
>
> To address concerns that an estate tax could apply to gifts exempt from gift tax by the increased BEA, the final regulations provide a special rule that allows the estate to compute its estate tax credit using the higher of the BEA applicable to gifts made during life or the BEA applicable on the date of death.[18]

This regulation provides taxpayers with comfort in TCJA estate and gift planning transactions.

Business-Related Tax

Qualified Business Income Deduction

Prior to the TCJA, owners of pass-through entities (sole proprietorships, S corporations, limited liability companies (LLCs), or partnerships) paid taxes on business income at their own individual income tax rates.[19] In order to keep pass-throughs in roughly the same relative tax position as C corporations, the TCJA created a new deduction for owners of certain pass-through entities—a deduction of 20% of the owner's share of qualified business income (QBI) on their individual tax return, whether they itemize or not.[20] The QBI deduction equals 20% of QBI from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust, or estate. However, the QBI deduction is limited by two factors:

- the unadjusted basis immediately after acquisition (UBIA) of qualified property held for use in the trade or business
- the W-2 wages paid by the business[21]

Businesses ***not*** eligible to claim the QBI deduction include businesses taxed as C corporations and a number of "specified service trades or businesses."[22] A specified service trade or business is any trade or business:

- that involves the performance of services in the fields of accounting, actuarial science, athletics, brokerage services, consulting, financial services, health, law, or the performing arts;
- that involves the performance of services consisting of investing and investment management, trading, or dealing in securities, partnership interests, or commodities; or
- whose principal asset is the reputation or skill of one or more of its employees or owners.[23]

Limitation on Excess Businesses Losses

The TCJA limits the amount a business can claim as a loss in excess of their income, requiring the business to carry the rest forward in subsequent tax years.[24] The carryforward excess loss triggers if the business' operating loss exceeds operating income by more than $250,000 ($500,000 for joint filers), indexed for inflation. If this section of the TCJA expires, businesses may once again claim their full losses all in the same year.

Chained CPI for Inflation-Adjusted Numbers

Beginning in 2019, inflation adjustments are based on the Chained Consumer Price Index for All Urban Consumers.[25] The "chained CPI" is a measurement of consumer prices prepared by the Bureau of Labor Statistics that takes into account the substitutions consumers make in the face of rising prices.[26] The proponents of chained CPI believe that it is a more accurate measurement of inflation, while critics argue that it may underestimate the cost of living in certain groups.[27] The impact of using chained CPI has been generally smaller annual inflation adjustments for everything from tax bracket income levels to Social Security benefits.

TCJA Permanent Changes

While most TCJA provisions are set to expire, there are some that will not be impacted by the sunset.

Corporate Tax Rates

One of the largest modifications in the TCJA was the reduction in corporate tax rates. Rates moved from eight tax brackets with a top rate of 35% to one flat rate of 21%.[28] This flat corporate tax is permanent.

Corporate AMT

Heralded as a key provision to improve the corporate tax environment, the TCJA permanently repealed the corporate AMT.[29] However, in 2023, the Inflation Reduction Act created a new Corporate Alternative Minimum Tax (CAMT).[30] The CAMT is a minimum tax that applies to "applicable corporations" and is based on adjusted financial statement income (AFSI).[31] The CAMT imposes a 15% minimum tax on the AFSI of corporations with average annual financial statement income exceeding $1 billion.

Affordable Care Act Insurance Mandate

The TCJA permanently removed the penalty for failing to comply with the Affordable Care Act's insurance mandate by dropping the penalty amount to $0.[32]

Like-Kind Exchanges

The TCJA provided that IRC §1031 like-kind exchanges are only available for exchanges involving real property.[33] Any exchange of personal property (aircraft, watercraft, fleet vehicles, machinery, etc.) was made into a taxable transfer. However, it is important to note that the TCJA did not make any changes to IRC §1035, which allows tax-free exchanges of certain life insurance policies and annuities.

Mitigating the Risk

The impact of the sunset is uncertain. Congress may act on one or more of these items at any point, may choose not to act, or may fail to act because they cannot agree on what should be done. Despite this uncertainty, financial professionals should prepare taxpayers for the potential risks associated with Congress allowing these provisions to sunset and explain how these changes may impact their unique circumstances. There are a few basic steps that some clients might want to consider.

Income Tax

While no two taxpayers have exactly the same tax situations, individuals in the higher tax brackets may want to prepare for the upcoming expansion of income tax brackets and the return of higher income tax rates.

- Taxpayers who operate within a strict financial budget may want to review their withholdings and estimated tax payments and budget for a greater income tax bill.
- Taxpayers who benefit from the increased standard deduction should prepare for a return of substantiation requirements for itemized deductions. They will need to keep additional records of items they plan to take as federal income tax deductions—mortgage interest paid, state and local taxes paid, charitable gifts made, etc.— to satisfy IRS substantiation requirements. Taxpayers with higher-value homes or who live in an area with substantial state and local taxes will be glad to "keep their receipts" so they can once again take the SALT deduction.

Estate and Gift Tax

Estate planning may be the area with the most risk for taxpayers if the TCJA sunsets since the estate and gift tax exemption, which doubled under the TCJA, would be cut in half. The TCJA pushed the exemption from $5 million to $10 million ($13.61 million in 2024), meaning many people could plan their estate without much concern about federal estate taxes. However, if the sunset drops the 2026 estate and gift tax exemption down into the $7 million range, this could devastate the estate plans of many professional couples or business owners who previously considered themselves firmly in the middle class but whose incomes and rising home values will subject their estate to tax. Informing clients who fall into this category can greatly mitigate their risk.

Consider the following estate planning steps:

1. Bypass Trust

Married couples enjoy the unlimited marital deduction for the gift and estate tax (for U.S. citizens only). In addition, the portability of the deceased spouse's unused exclusion amount means the surviving spouse may be able to utilize the full amount of the lifetime exclusion, potentially resulting in a larger tax-free estate for the surviving spouse. However, the estate will be fully taxed at the death of the second spouse.

In preparing for the potential sunset of the higher exemption amount, married couples might consider the bypass trust (also known as the credit shelter trust) to pass assets to beneficiaries at the death of a first spouse, making full use of the applicable credit amount at each spouse's death to avoid estate taxation at the second spouse's death. With a bypass trust, there will be no federal estate taxes due at the death of the first spouse. The will divides the estate into two parts:

- One part, equal to the estate exemption amount, is placed in the trust. It is sheltered from tax by the first spouse's applicable exemption. The trust may provide liberal benefits to the surviving spouse but will bypass the surviving spouse's estate at death.
- The other part either passes outright to the surviving spouse (sheltered from tax by the unlimited marital deduction) or is placed in a marital deduction trust for the spouse's benefit.

At the second death, the surviving spouse can use the applicable credit amount (plus any available deceased spousal unused exclusion amount) to shelter additional assets.

2. Estate Reduction through Annual Gifts

Taking advantage of the gift tax annual exclusion is a simple and effective way to reduce the size of the estate (and therefore any gift and estate tax) while keeping assets in the family or with friends. This tool can be a particularly effective way for clients to pass significant assets to their family members as part of a continuing series of annual gifts.

Each individual is allowed to give up to $18,000 (in 2024) to an unlimited number of donees without incurring the federal gift tax. The annual exclusion for gifts from a donor spouse to a non-citizen spouse is $185,000 (in 2024). Married couples may also make use of gift-splitting, whereby both spouses can join together in a present-interest gift to a third party, even if the gift property comes entirely from one spouse. The spouses must file a gift tax return to elect gift-splitting.

In addition, gifts beyond the annual exclusion amount made before January 1, 2026, will not be subject to the reduced exemption amount, and the IRS has stated that for large, lifetime gifts made now, it will not "claw back" taxes once the exemption amount is reduced.

3. Estate Reduction through Charitable Gifts

Another way clients can reduce the size of their estate is by making charitable gifts. For those who are so inclined, gifting assets accomplishes a philanthropic goal, removes assets from the estate, and often comes with tax benefits for the donor.

Alerting Clients to Potential Danger

In the classic movie *Groundhog Day*, Bill Murray's character, Phil Connors, tries to break out of a time loop by engaging in dangerous activities, only to wake up the next morning to start the day over. And over. And over. While Phil could ignore the warning sign for a gravel pit and drive off a cliff without consequence, a taxpayer who avoids the warning signs about the sunset of the TCJA will not have such a do-over.

If Congress allows a reversion to the prior tax law, taxpayers should be prepared to handle the proverbial "dangerous curve" ahead. By helping clients make adjustments to their financial and estate plans now, they will be able to cruise with confidence, fully prepared to ride off into the sunset.

ENDNOTES

1 26 U.S.C. §1(j).
2 26 U.S.C. §151.
3 26 U.S.C. §151(d)(5).
4 26 U.S.C. §68.
5 26 U.S.C. §164.
6 26 U.S.C. §164(b)(6).
7 26 U.S.C. §163(h)(3)(B)(ii).
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9 26 U.S.C. §163(h)(3)(F)(i)(I).
10 26 U.S.C. §170(b)(1)(G).
11 26 U.S.C. §217(k).
12 26 U.S.C. §529A.
13 26 U.S.C. §529A(b)(2)(B).
14 26 U.S.C. §529(c)(1)(C).
15 26 U.S.C. §38(c)(6)(E).
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20 26 U.S.C. §199a.
21 26 U.S.C. §199a(b)(2).
22 26 U.S.C. §199a(d)(2).
23 Id.
24 26 U.S.C. §461.
25 26 U.S.C. §1(f).
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30 26 U.S.C. §§53, 55, 56A, and 59.
31 26 U.S.C. §56A.
32 26 U.S.C. §5000A.
33 26 U.S.C. §1031.

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