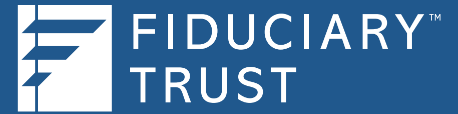
Planning Opportunities Before the Tax Cuts and Jobs Act Sunset



Wealth Planning Insights

Should you take action now? Absolutely! Absent further congressional action, significant beneficial changes that were implemented by the Tax Cuts and Jobs Act of 2017 (TCJA) will expire, or "sunset," on December 31, 2025. Now is the time to begin reviewing the details of your estate plan and personal tax situation to optimize your tax savings before the sunset. While new legislation could change or extend some or all of these provisions, you should be aware of the wealth transfer and income tax planning opportunities that are available, and be prepared to take action during 2024 and 2025 if appropriate to meet your goals.

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Estate and Gift Tax Exemption

The TCJA added a "bonus" exemption amount that doubled the amount of the then-current federal estate and gift tax exemption and indexed it for inflation. That amount has continued to increase each year, resulting in an exemption amount of $13.61 million per person, or $27.22 million for a married couple, in 2024. This amount will again be indexed for inflation in 2025 but will drop back to an inflation-adjusted 2017 level on January 1, 2026, which is projected to be in the $7 million range per person or $14 million per couple. The same sunset provisions also apply to the federal Generation Skipping Transfer Tax (GSTT) exemption.

With the estate and gift tax exemption as well as GSTT exemption amounts scheduled to be reduced by one-half, it is most beneficial from a wealth transfer perspective to fully utilize the increased exemptions before they disappear at the end of 2025. Due to how this is calculated, if a married couple only wishes to gift a total of $13.61 million, it is more advantageous for one spouse to fully use their exemption and not elect gift-splitting than it is for each spouse to use one-half of their respective exemptions. This is because the increased exemption is "use it or lose it," with gifts made prior to the sunset reducing any post-sunset exemption amount.

Only taxable gifts count against the estate and gift tax exemption

Remember that only taxable gifts count against the estate and gift tax exemption. Taxable gifts are any gifts that (i) do not qualify for the marital or charitable deduction, (ii) are in excess of the annual exclusion amount ($18,000 per recipient in 2024), or (iii) are not medical or tuition expenses paid directly to the provider. Taxable gifts are required to be reported on a federal gift tax return (Form 709) for the calendar year in which the gifts are made. If you live in a state that imposes a state-level estate tax, such as Massachusetts, making gifts during your lifetime may also reduce the state-level estate taxes that may be due on your death.

If transferring wealth to your children and future generations is among your goals, and you have sufficient assets to make significant taxable gifts and maintain your lifestyle without concern, you should consider maximizing the use of your gift tax exemption before December 31, 2025, by employing one or more of the following strategies:

- **Dynasty Trust:** A dynasty trust is an irrevocable trust that is designed to transfer wealth across multiple generations while minimizing transfer taxes. By applying your gift tax and GSTT exemption to the transfer of assets into the trust, the value of those assets and any post-gift appreciation would be sheltered from federal estate taxes upon your death, the trust would be made exempt from the GSTT, and the trust property could be administered for the benefit of your beneficiaries for many years to come. In addition, if you chose a tax situs such as New Hampshire, the trust could be structured to last in perpetuity and enjoy state income tax benefits as well.
- **Spousal Lifetime Access Trust (SLAT):** If you have sufficient assets to make a significant lifetime gift into an irrevocable trust but want to include a safety net that would allow your spouse to be a discretionary beneficiary of the trust during his or her lifetime, you should consider a SLAT. The trustee of the SLAT could make distributions to your spouse as well as other beneficiaries, such as children, grandchildren, family members, or friends. Because gift tax exemption is applied to the transfer of property into the SLAT, the most tax-efficient approach is for the beneficiary-spouse to avoid requesting distributions from the trust, if possible, thereby allowing the SLAT's assets to increase in value and ultimately pass for the benefit of non-spousal beneficiaries. Similar to the Dynasty Trust discussed above, it is often advisable to allocate GSTT exemption to the SLAT if the trust property will be held for the benefit of multiple generations. In addition, SLATs are often designed as so-called "grantor trusts," which allow the donor to pay the trust's income taxes on his or her individual income tax return. Doing so has the effect of further reducing the donor's taxable estate without making further taxable gifts while enabling the SLAT's assets to grow income tax-free.

Please note that if both spouses wish to create SLATs, the terms of each trust need to be substantially different to avoid the "reciprocal trust doctrine," which, if applicable, would entirely nullify the transfer tax planning objective of SLATs.

- **Insurance Trusts:** If you have or would like to have an irrevocable life insurance trust (ILIT) own life insurance on yourself and/or your spouse, consider funding an ILIT using a portion of your gift tax exemption. This may be accomplished by creating an ILIT and gifting cash to the trust, such that the ILIT may purchase a new policy, or by transferring an existing policy into the ILIT by gift. In the latter case, if the donor is also the insured and dies within three years of the transfer, then the policy proceeds will be includible in the donor's gross estate. If properly drafted, you could also consider utilizing an existing SLAT or dynasty trust to purchase life insurance.
- **Outright Gifts:** In addition to using trusts, you can also make outright gifts to non-spousal and non-charitable recipients, which would utilize your gift tax exemption as long as the gift is a taxable gift. If you are making outright gifts to skip persons such as grandchildren, you can also apply your GSTT exemption to those gifts. Depending on your wealth transfer goals and specific family situation, outright gifts may be a good option because of their simplicity.

Income Recognition

The revisions to the federal income tax rates provided in the TCJA also sunset at the end of 2025, with tax brackets and rates returning to their pre-TCJA levels. This will result in the top ordinary income tax rate returning to 39.6% on January 1, 2026, up from the current 37% top rate. For married couples filing jointly, the 37% bracket is reached at $731,200 of ordinary income in 2024, while the top bracket of 39.6% will be reached at a much lower threshold of ordinary income in 2026. This narrowing of tax brackets results in higher overall federal income tax liabilities for higher-income taxpayers, and tax rates that are up to 4.6% higher at some levels. To reduce your future tax liability, you may consider accelerating ordinary income or transferring income-producing assets to lower-earning family members. Capital gains tax rates will not change.

Some income tax planning opportunities to consider include the following:

- **Accelerate Ordinary Income:** If your top ordinary income tax rate after the sunset is projected to be higher than it is today, you should consider accelerating ordinary income into 2024 or 2025 to take advantage of the reduced tax rates. This decision needs to be balanced against the limitations on the state and local tax (SALT) deduction discussed below, as well as any state income tax implications. For example, if you are a Massachusetts taxpayer, you should be aware of the imposition of the 4% Massachusetts Millionaire's Tax (MMT) on income over $1 million. The MMT, combined with the reduced SALT deduction, can mitigate the benefit of pulling ordinary income forward to take advantage of the current federal income tax brackets.

  Please note that passthrough business income is also subject to these higher federal rates in the future, and depending on what action the Massachusetts Department of Revenue ultimately takes under An Act to Improve the Commonwealth's Competitiveness, Affordability, and Equity enacted on October 4, 2023, such business income may also be negatively impacted by the MMT.

To reduce your future tax liability, you may consider accelerating ordinary income or transferring income-producing assets to lower-earning family members

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Roth IRAs are also a highly tax-efficient asset to leave to children or grandchildren, either outright or in trust

- **Roth IRA Conversions:** Taking advantage of the current federal income tax rates by converting some or all of your traditional IRA or 401(k) assets to a Roth IRA can be a compelling planning move, especially if you can pay the related income taxes from non-IRA sources. The significant advantage of Roth IRAs is that their assets grow income tax-free, and there are no income tax consequences when assets are withdrawn from the Roth. In addition, Roth IRAs are not subject to required minimum distributions (RMDs) for the owner or their surviving spouse, which can help with the management of future income recognition. Roth IRAs are also a highly tax-efficient asset to leave to children or grandchildren, either outright or in trust. When traditional IRA assets are converted to a Roth IRA, income taxes must be paid on the amount converted but all future growth is tax-free. If you are interested in converting traditional IRA assets to Roth IRA assets, you have the opportunity to do this in stages by reviewing your 2024 and 2025 personal income tax situation and deciding what amounts, if any, could be converted at attractive tax rates compared to the post-sunset rates. Converting currently is especially attractive for taxpayers who have a long time horizon, will otherwise have a taxable estate, or whose RMD payments may be taxed at higher income tax rates in future years.

  Notably, if you have charitable goals and plan to pass your IRA assets to charity, you should maintain those assets in traditional IRA vehicles instead of Roth vehicles, so that you can take full advantage of Qualified Charitable Deductions (QCDs) in the most tax-advantaged way.

- **Traditional IRA Withdrawals:**

  i. Accelerate Withdrawals: In the spirit of accelerating ordinary income to enjoy the lower tax rates before the sunset, even if you do not want to convert all or a portion of your IRA assets into Roth IRA assets because you plan to use the withdrawals to support your lifestyle or other goals, you may want to accelerate your withdrawals beyond RMDs to take advantage of the lower tax rates during 2024 and 2025. This would generally only be advisable for someone over age 59½.

  ii. Utilize Qualified Charitable Deductions (QCDs): If you have philanthropic goals and will be subject to RMDs that you do not otherwise need, you should consider using QCDs. QCDs allow an individual who is over age 70½ to gift up to $100,000 per year, regardless of the amount of their RMD, to qualified charities. To qualify as a QCD, the gift must go directly from the IRA to the qualified charity. It should be noted that Donor-Advised Funds (DAFs) are not considered qualified charities for this purpose. For taxpayers subject to the top tax brackets, QCDs are often more attractive than gifting appreciated securities to charitable organizations and can help minimize income considered in determining Medicare premiums.

Itemized Tax Deductions

Due to changes to both the limits and composition of itemized deductions in the TCJA, more taxpayers have been relying on the standard deduction. The TCJA nearly doubled the standard deduction and imposed limitations on certain deductions, particularly the deduction for State and Local Income Tax, which resulted in fewer

taxpayers benefiting from itemization. This will change, however, as the standard deduction is scheduled to decrease to approximately one-half of its current levels, after inflation adjustments, in 2026. Being aware of how itemized tax deductions are impacted by the sunset and understanding how deductions could lead to greater tax savings after the sunset can lead to planning opportunities as well.

- **State and Local Income Tax (SALT):** The TCJA limited the deduction for SALT to $10,000 per tax return. Many taxpayers pay significantly more than this in state and local taxes when you consider income, real estate, and personal property taxes. The sunset of this $10,000 deduction limit will once again allow more individuals to itemize their deductions. As a result, it may be beneficial to delay the payment of the 4th quarter estimated SALT in 2025 to January 2026 in order to push the deduction into the 2026 tax year. Be aware, however, that SALT is an alternative minimum tax (AMT) adjustment item, which translates to more taxpayers once again being subject to the AMT. As much as you may wish to avoid the AMT, the good news is that the top tax rate is 28%, which is a bit of a bargain when compared to the 39.6% top ordinary tax rate that will return in 2026.
- **Mortgage Interest Deduction:** Effective in 2026, interest on the first $1,000,000 of mortgage debt, plus up to $100,000 of home equity debt, will be considered an itemized deduction. This is an increase from the $750,000 limit put in place under TCJA.
- **Charitable Deductions:** TCJA increased the top charitable deduction to 60% of adjusted gross income (AGI) for cash gifts to public charities. In 2026, this will revert to 50%, with the deduction for gifts of appreciated securities to public charities remaining at 30% of AGI. AGI deduction limits for gifts to most private foundations remain at 30% for cash and 20% for securities.

  As noted above, the ability for taxpayers over age 70 ½ to gift up to $100,000 per year using a QCD from their traditional IRA without counting it as taxable income is not impacted by the sunset of the TCJA.
- **Medical Expense Deductions:** The threshold for deducting medical expenses was decreased to 7.5% by TCJA. This decrease was later made permanent by subsequent legislation.
- **Casualty Losses:** TCJA limited the ability to deduct casualty losses to those incurred in a federally declared disaster area. Beginning in 2026, taxpayers will once again be able to deduct casualty losses regardless of whether they occurred in a federal disaster area. Be aware that a 10% AGI floor, as well as other rules, may apply to the ability to deduct these losses.
- **Moving Expenses:** After the sunset, the rules will change in favor of taxpayers. Reimbursed moving expenses will no longer be considered taxable income and a tax deduction will be allowed for qualifying unreimbursed moving expenses.
- **Miscellaneous Itemized Deductions:** Miscellaneous itemized deductions, such as investment management and trustee fees, tax planning and preparation fees, and unreimbursed employee expenses, will once again be deductible to the extent they exceed 2% of your AGI.

Being aware of how itemized tax deductions are impacted by the sunset and understanding how deductions could lead to greater tax savings after the sunset can lead to planning opportunities as well

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- **Itemized Deduction Limitation:** Often referred to as the Pease limitation, this itemized deduction limitation will return with inflation indexing with the sunset of the TCJA. This limitation will once again limit the amount of itemized deductions that high-income taxpayers can take by reducing the aggregate total of certain itemized deductions by up to 3% of the amount that AGI exceeds inflation-indexed thresholds. Itemized deductions included under this limitation are mortgage interest, SALT, charitable contributions, and certain miscellaneous itemized deductions.

Business Income

The TCJA provided a permanent reduction in corporate income tax rates to 21%. In order to level the playing field for passthrough entities, it also introduced a Qualified Business Income (QBI) Deduction that allowed an individual to obtain a 20% deduction against QBI passthrough business income under Section 199A. Without further congressional action, the QBI deduction will sunset on December 31, 2025, with 100% of QBI income being taxable beginning in 2026, creating a significant disparity in the taxation of C corporation income compared to passthrough entity income. Although taxes should not be the sole consideration when deciding on the structure of a business entity, it is important to take them into account in the overall tax planning context.

Alternative Minimum Tax

The increase in the AMT exemption and phaseout threshold under the TCJA will sunset and revert back to prior levels. This, coupled with the expansion of the AMT tax preference items such as the SALT itemized deduction, will result in more taxpayers once again being subject to the AMT. This will create an opportunity for taxpayers who may be able to control the timing of ordinary income or deduction recognition to engage in additional income tax planning to manage their income tax liability. It may also affect whether high-income taxpayers choose to invest in municipal versus corporate bonds.

The possible sunset of many provisions of the TCJA has led estate planners and financial advisors to anticipate an extremely busy year-end in 2025, but there is no reason to wait. Now is the time to have proactive conversations with your wealth planning advisors regarding whether any of these potential estate and tax planning opportunities are appropriate for you in meeting your goals. ■

Source: Internal Revenue Service

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