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Tax Cuts and Jobs Act Expiration: What You Should Know to Plan Ahead

With the second half of 2024 on the horizon, it is important to be aware of the impending changes that will ensue in the tax and estate planning world at the end of next year and will become effective (as of this writing) January 1, 2026. We will highlight what will be changing, why it is important, and strategies to consider in preparation of this expiration.

What is changing?

In 2017, the Tax Cuts and Jobs Act (TCJA) was implemented. The overarching goal of this legislation was to provide tax relief to individuals and businesses, to spur economic growth and job creation, and to simplify the tax system. The legislation aimed to achieve these objectives through a combination of changes to tax rates, deductions, credits, and other provisions. What specifically changed? Quite a bit, but to list a few:

- Reduction of individual tax rates across various brackets
- Increase of the standard deduction (nearly doubled) which ultimately simplified tax filings for taxpayers
  - In 2020, only ~10% of taxpayers itemized their deductions compared to 30% in 2017 prior to the TCJA
    - Contributing to this statistic is that the cap on the state and local tax (SALT) deduction of $10,000
- Introduction of the Qualified Business Income (QBI) deduction which allows eligible taxpayers to deduct up to 20% of flow through qualified business income
- Doubling of the estate tax exemption from $5.5M per individual to $11.2M, indexed for inflation (for 2024, that amount is $13.61M per individual)

The full list of changes with this legislation can be accessed on the following government websites:
https://www.congress.gov/115/bills/hr1/BILLS-115hr1enr.pdf
https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-a-comparison-for-businesses

This law was not intended to be in place indefinitely. It was, and still is, set to expire on December 31, 2025, and beginning on January 1, 2026, the law reverts to 2017 law. This includes (but is not limited to) the following:

- Individual tax rates will increase across the various brackets.
- The standard deduction will decrease (anticipating this will be approximately cut in half).
  - This also means the SALT deduction will not be limited to $10,000 which will be beneficial for individuals with high real estate taxes and/or living in states with high income tax rates.
- QBI will no longer be a deduction.
- The estate tax exemption will be approximately cut in half (we anticipating this to be ~$7M per individual). More on this later.

Why is this important?

In short, from an income tax perspective, with many deductions and credits expiring coupled with higher tax rates, many taxpayers will have larger tax bills to pay beginning in 2026. The below table shows the changes in tax rates and the income brackets in 2017 (pre-TCJA) vs. 2018 (first year of the TCJA). The 2024 brackets are included for reference– even though the rates have stayed in the same since 2018, the brackets have been adjusted annually for inflation.

	2017	
Tax Rate	Lower Income Bound	Higher Income Bound
10%	$ -	$ 18,650
15%	$ 18,651	$ 75,900
25%	$ 75,901	$ 153,100
28%	$ 153,101	$ 233,350
33%	$ 233,351	$ 416,700
35%	$ 416,701	$ 470,700
39.6%	$ 470,701	> $470, 701

	2018	
Tax Rate	Lower Income Bound	Higher Income Bound
10%	$ -	$ 19,050
12%	$ 19,051	$ 77,400
22%	$ 77,401	$ 165,000
24%	$ 165,001	$ 315,000
32%	$ 315,001	$ 400,000
35%	$ 400,001	$ 600,000
37%	$ 600,001	> $600,001

	2024	
Tax Rate	Lower Income Bound	Higher Income Bound
10%	$ -	$ 20,550
12%	$ 20,551	$ 83,550
22%	$ 83,551	$ 178,150
24%	$ 178,151	$ 340,100
32%	$ 340,101	$ 431,900
35%	$ 431,901	$ 647,850
37%	$ 647,851	> $647,851

Note: Income brackets reflect married filing jointly taxpayers.

For a simple example, a household filing a joint income tax return in 2024 that has W2 income of $200,000 can expect to pay ~$27,700 in Federal income taxes. In 2026, that same household (assuming $200,000 of W2 income) will have a tax bill ~$35,500 or ~28% increase. If that same household was also earning $100,000 of flow through business income in 2024 where they were benefiting from the QBI deduction, their taxes in 2026 will be closer to ~35% higher when compared to 2024.

From an estate tax perspective, the exemption being cut in half could impact your gifting power going forward. If you have utilized less than ~$7M of your lifetime exemption through gifting, you did not utilize any of the "bonus" exemption that was allowed in 2018. For example, if you utilized $1M of your lifetime exemption, when the law reverts to pre-TCJA levels (~$7M in exemption), your remaining lifetime exemption will be ~$6M. In order to take advantage of the "bonus" exemption before it expires December 31, 2025, you must gift **more than** ~$7M. If you are not able to or do not intend to make gifts exceeding $7M, there is no rush to make gifts prior to the expiration. Additionally, the IRS has stated that any gifts made through lifetime will be shielded by the "anti-clawback rule" once the TCJA provisions sunset, ensuring your estate will not be taxed on gifts made during the increased exemption period (2018 - 2025) at death.

Strategies to Consider

So now what? While everyone's situation is different, below are a few general strategies to consider before the TCJA expires.

Income Tax Planning

-Defer charitable donations to 2026

- Tax deductions have a larger impact when you are in a higher tax bracket (more bang for your buck). More taxpayers will not only itemize their deductions beginning in 2026 with the standard deduction decreasing, but could also be in a higher tax bracket and their donations will reduce their tax liability more than in 2024/2025.

-Defer real estate and state income taxes to 2026 instead of paying in 2025, if no late penalties will be generated due to deferral.

-Reduce taxable income beginning in 2026 to the extent possible. Some examples include:

- Rebalance portfolio from taxable bonds to tax-exempt municipal bonds.
- Max out employer sponsored traditional retirement accounts.
- Accelerate income to 2024/2025, if you have the option
  - For example, if you have an inherited IRA account that requires you to withdraw from the account in 10 years, consider taking more in 2024/2025 while in a lower tax bracket.
- Tax-loss harvesting - sell securities in portfolio that are at a loss to reduce taxable capital gains.

Estate Tax Planning

-Spousal Lifetime Access Trust (SLAT)

- Creating and funding a SLAT allows married individuals to leverage each other's gift tax exemptions while retaining indirect access to trust assets through a spouse. By funding a SLAT with assets up to the current exemption limit, individuals can effectively utilize their exemption amounts while maintaining flexibility and access to the trust assets if needed.
- SLATs offer a unique combination of estate tax planning and asset protection benefits as well. They enable spouses to transfer assets out of their taxable estates while still providing a degree of control and access to trust assets.

-Limited Liability Company (LLC)

- Gifting membership interests in an LLC to family members (typically to children of the donor) can be an efficient way to transfer assets out of the donor's taxable estate and transfer wealth to the next generation, while allowing the donor to retain control of the assets. Additionally, family LLCs provide a great opportunity for education to the next generation and family governance.
- Discounts on the valuation can be taken to leverage the amount of lifetime exemption utilized in comparison to the dollars gifted.

-Irrevocable Life Insurance Trust (ILIT)

- If you are not ready to gift assets but will still have a taxable estate after the TJCA sunset, you can set up an ILIT and obtain a life insurance policy with the trust as the owner and beneficiary.
- The life insurance policy will be out of your taxable estate, not subject to estate taxes upon death, and the death benefit proceeds from the policy can be utilized by the beneficiary of the trust to pay the estate tax owed upon death of the grantor. The advantage being that the beneficiary will not need to liquidate any of their inherited assets to pay the estate taxes owed.

-Charitable Remainder Unitrusts (CRUTs)

- For individuals who are charitably included, this may be an attractive option by transferring appreciated assets out of their estate while maintaining an income stream during their lives. Once the term of the trust expires (typically at death), the balance would be transferred to a charity (or charities) of the donor's choosing.
- There are also tax benefits to transferring appreciated assets to the CRUT. The recognition of the taxable gain will be spread out over numerous years vs. in the year of sale. Additionally, the donor will receive an immediate charitable deduction for the present value of the remainder interest that will eventually pass to charity.

When making gifts, cash flow should be considered. How much can you afford to gift without impacting your livelihood? Additionally, these strategies should be utilized thoughtfully and coincide with your long-term goals.

There is no silver bullet when it comes to estate planning and the above strategies are not all inclusive of the available options. It is also important to note that, at times, utilizing a combination of strategies can be most effective. Proactive tax and estate planning are essential components of financial stewardship - particularly in anticipation of legislative changes such as the expiration of the Tax Cuts and Jobs Act. Employing strategies that are consistent with your long-term goals can maximize estate tax emptions and preserve wealth for future generations.

As always, please do not hesitate to contact us with any questions regarding how these changes may impact you.

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