

TCJA Sunset

& WHAT IT MEANS FOR YOU



As the 2024 election approaches, the question on everyone's mind is who will ultimately control the White House and Congress. These are important questions, but the reality is that regardless of the election outcome, one thing is certain: tax policy will inevitably change when the Trump-era Tax Cuts and Jobs Act (TCJA) of 2017 expires in 2025. Here we will explore some of the potential implications of these changes and discuss strategies that your financial professional can suggest to help you manage potential tax risks.

What Changed Under TCJA?

The Tax Cuts and Jobs Act (TCJA) of 2017 is a collection of sweeping tax reforms for individuals and businesses. TCJA offered substantial permanent tax cuts to corporate bodies and lowered tax rates for individuals by restructuring the tax brackets. The standard deductions nearly doubled in 2018:

- \$24,000 from \$12,700 for married couples filing jointly (\$27,700 in the 2023 tax year)
- \$12,000 from \$6,350 for single filers (\$13,850 in the 2023 tax year)
- \$18,000 from \$9,350 for heads of household (\$20,800 for the 2023 tax year)¹

The TCJA also changed the measurement used for inflation indexing resulting in a smaller upward adjustment each year.² How these changes impact

Americans varies from household to household and depends on filing status, level of income, and even location, especially in states with higher taxes and property values. Tax code wasn't the only thing to change under TCJA. The act permanently removed the individual mandate of the Affordable Care Act, which raised insurance premiums and significantly reduced health coverage for an estimated 13 million Americans.³ Unlike the other TCJA adjustments, this mandate will not be repealed in 2025.

Expiring Adjustments in 2025

Unless Congress steps in with extensions or other changes, all of the tax code adjustments under TCJA will revert back to 2017 levels on December 31, 2025. Aside from the Affordable Care Act, the only exceptions will be the 21% corporate tax rate and long-term capital gains tax rates, which will not expire. Here's what you can expect when TCJA sunsets.

- Individual income tax rates will return to their 2017 levels.
- The standard deduction will be cut roughly in half and the personal exemption will return.
- The child tax credit (CTC) will be cut.
- The estate tax exemption will be reduced.
- The 20% tax deduction for most pass-through businesses will vanish.
- The cap on the state and local income Tax (SALT) deduction will be revoked.

^{1,2} <https://www.taxpolicycenter.org/briefing-book/how-did-tcja-change-standard-deduction-and-itemized-deductions>

³ <https://www.investopedia.com/taxes/trumps-tax-reform-plan-explained/>

While it's still possible for Congress to extend the current tax structure or make other changes, on the whole, taxes are expected to increase for the majority of Americans. But keep in mind, even if TCJA is extended, deficits in programs like Social Security and Medicare might still result in tax hikes now and into the future.

Pre-Sunset Tax Strategy Options

The problem with trying to plan for the TCJA sunset is that the political situation will likely be uncertain or fluctuating by the time 2025 arrives. Additionally, there is always the question of whether TCJA will actually be allowed to expire and what new tax laws will be introduced to replace it (if any). Since no one can predict the future, prepare for it instead by familiarizing yourself with the core provisions on the docket and create a plan to use those that make sense for you while they're still available.

Estate and Gift Exemptions

The gift exemption is currently at \$12.92 million per person, its highest historic level. On January 1, 2026, it is scheduled to revert to \$5 million, adjusted for inflation (the pre-TCJA level).⁴ Since the IRS plans to not enact a "clawback rule," you can avoid taxation on any assets given as outright gifts made before the current rules sunset up to this limit (barring any other special conditions around those funds that may result in taxation). Something to keep in mind about this strategy: it only applies to people who have more than \$5 million in assets to gift away and that any assets you do manage to give away could become the source of a significant tax liability for the recipients. The bottom line? Think before you gift and consult your tax professional and financial planner first.

Tax Rate Modifications

When the tax rates return to their 2017 levels, individuals and married couples can expect higher tax rates with lower income thresholds. In this scenario, it may be prudent to pay taxes on certain assets now while the rates are lower. One way to do this is by converting part or all of your funds in a traditional IRA or 401(k) to a Roth IRA. Keep in mind that you will need to pay ordinary income tax on any pre-tax dollars and converted investment gains. However, the key advantage is that you won't have

to pay taxes on these funds again when you start making withdrawals during retirement, after age 59-1/2 and the account is at least 5 years old. Additionally, beneficiaries of inherited retirement accounts have 10 years to deplete them before incurring a tax liability. It is generally preferable for these funds to be tax-free rather than tax-deferred.

Qualified Business Interest Deduction

The qualified business interest deduction (QBI) allows certain businesses, such as S corporations and LLCs, to deduct up to 20% of their business income. While this deduction will expire at the end of 2025, it does not apply to the corporate tax rate, which will remain at 21%. As a result, many businesses may consider converting from a pass-through entity to a C-corp to avoid the sunset rules. However, this is a costly and significant step to take. By becoming a C-corp, these businesses will also be subject to taxation at both the corporate level and the individual level when distributing profits.

Alternative Minimum Tax Rates

When completing a tax return, two numbers are calculated behind the scenes that might have a significant impact on your tax liability. One is the income tax liability, and the other is the alternative minimum tax (AMT) liability. The taxpayer is responsible for the higher amount between the two. The TCJA increased the threshold for determining if a taxpayer is subject to the AMT. Once this increase expires, a significant number of taxpayers who previously paid under the traditional tax structure will now be subject to the AMT rates. One strategy to consider is to exercise incentive stock options (ISOs), but whether this strategy is suitable for you depends on the availability of ISOs and the direction of movement for those stocks.

Ready for Change on the Horizon

As you prepare for the shifting rules and political unpredictability of the elections and Congress, the best strategy to keep in mind is to arm yourself with knowledge. It's important for both you and your financial professional to explore all your available options, to carefully review and potentially diversify your assets, and to accurately target your goals for retirement.

⁴ <https://www.nerdwallet.com/article/taxes/gift-tax-rate#:~:text=How%20the%20lifetime%20gift%20tax,than%20the%20annual%20exclusion%20amount.>