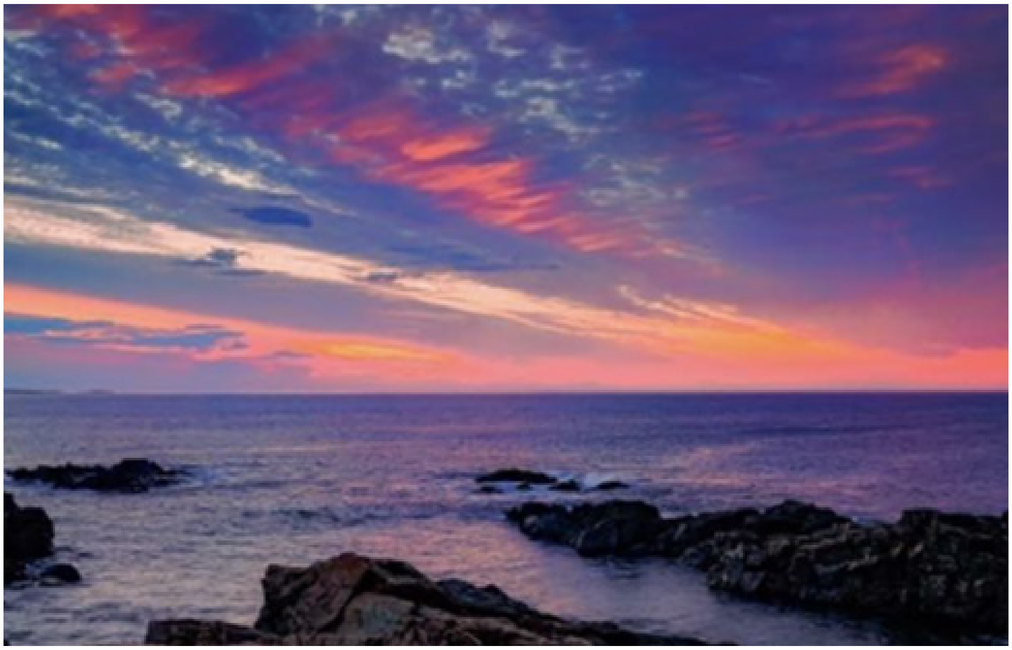
The 2017 Tax Cuts and Jobs Act and the Setting Sun

June 2024

SUMMARY

This newsletter provides an overview of the current individual income tax, estate tax, and gift tax environment and outlines some of the major provisions of the 2017 Tax Cuts and Jobs Act (TCJA) that are set to expire.



INTRODUCTION

Many of the TCJA's ***business-related*** tax provisions are permanent, including the 21% corporate tax rate, the repeal of the corporate alternative minimum tax, limitations on business interest deductions, and changes to net operating losses (NOLs).

> *One significant business provision that is due to expire is the Section 199A deduction, which permits a 20% deduction on qualified business income (QBI) for individuals, non-grantor trusts, or estates with QBI from "pass-through" entities such as partnerships, S corporations, rental properties reported on Schedule E, and farm operations reported on Schedule F. This deduction is subject to specific limitations based on W-2 wages paid, the unadjusted basis of qualified property, and taxable income. Since this deduction will expire in 2025, qualifying entities should make the most of this tax savings opportunity while it is still available.*

On the other hand, by the end of 2025, many ***individual*** income and estate tax provisions of the TCJA will sunset, significantly changing the tax landscape. Let's review several of those changes.

MAJOR EXPIRING INCOME TAX PROVISIONS:

Tax Brackets: The expiration of income tax cuts enacted by the TCJA will directly affect many Americans. With the sunset, personal income tax brackets will revert to pre-TCJA levels, which means many taxpayers will see their tax rate increase. For example, the top individual, estate and trust income tax bracket would go back up to 39.6 percent from the current rate of 37 percent.

Here is a comparison of how tax rates would differ upon expiration of the TCJA:

Married couples filing a joint return:

Taxable Income	2023 tax rates	Projected tax rates	Difference
$0 - $22,000	10%	10%	0.0%
$22,001 - $89,450	12	15	3.0
$89,451 - $180,000	22	25	3.0
$180,001 - $190,750	22	28	6.0
$190,751 - $274,400	24	28	4.0
$274,401 - $364,200	24	33	9.0
$364,201 - $462,500	32	33	1.0
$462,501 - $490,000	35	33	2.0
$490,001 - $553,600	35	35	0.0
$553,601 - $693,750	35	39.6	4.6
Over $693,750	37	39.6	2.6

SINGLE FILERS:

Taxable Income	2023 tax rates	Projected tax rates	Difference
$0 - $11,000	10%	10%	0.0%
$11,001 - $44,725	12	15	3.0
$44,726 - $95,375	22	25	3.0
$95,376 - $108,000	24	25	1.0
$108,001 - $182,100	24	28	4.0
$182,101 - $225,400	32	28	4.0
$225,401 - $231,250	32	33	1.0
$231,251 - $490,000	35	33	2.0
$490,001 - $492,000	35	35	0.0
$492,001 - $578,125	35	39.6	4.6
Over $578,125	37	39.6	2.6

*Sources: Internal Revenue Service and Putnam Investments Research. Projected tax rates are estimated and based on analysis of 2017 tax rates prior to passage of the TCJA, with tax bracket figures adjusted to account for annual inflation adjustments through 2023.

Personal Exemptions: Temporarily repealed under the TCJA, personal and dependent exemptions will return in 2026 at pre-TCJA levels, adjusted for inflation. In 2017, the exemption amount was $4,050, with phase-outs for higher adjusted gross income (AGI) levels.

Standard Deduction: The TCJA nearly doubled the standard deduction, currently $29,200 for married couples filing jointly (MFJ), $14,600 for single filers, and $21,900 for heads of household. These amounts will revert to pre-TCJA levels in 2026, adjusted for inflation.

Limitations on Itemized Deductions (Pease Limitation): Currently, there are no income limitations on itemized deductions. Without new legislation, limitations will return in 2026, reducing itemized deductions for high AGI taxpayers, with exceptions for medical expenses, investment interest, and casualty/theft losses.

State and Local Taxes and Property Taxes (SALT): The TCJA capped SALT deductions at $10,000 ($5,000 for married filing separately, and the cap does not apply to business-related taxes on Schedules C, E, or F). In 2026, taxpayers may once again be able to benefit from deducting the full amount of their state taxes. For example, it may be beneficial to delay the payment of the 4th quarter estimated SALT in 2025 to January 2026 to push the deduction into the 2026 tax year. However, this could lead to higher AMT for taxpayers in high-tax states starting in 2026.

Charitable Contributions: The TCJA temporarily increased the deduction limitations for cash contributions from 50% to 60% of AGI. This limitation will revert to 50% in 2026.

Mortgage Interest: For taxpayers taking new mortgages after the effective date, the TCJA limited the deductibility to the interest on the first $750,000 of home mortgage debt and suspended the deductibility on home equity up to $100,000 of indebtedness on loans unless they are used to buy, build or substantially improve the taxpayer's home. All of these deductions will revert back to pre-TCJA levels for 2026.

Miscellaneous Deductions: Suspended for 2017-2025, miscellaneous deductions subject to a 2% AGI floor will return in 2026. These deductions include tax preparation fees, investment advisory fees, and unreimbursed employee business expenses, disallowed for AMT purposes.

Alternative Minimum Tax (AMT): Increased AMT exemption amounts and phase-out thresholds under the TCJA will revert to lower pre-TCJA levels in 2026, potentially causing more taxpayers to owe AMT.

Bonus Depreciation: The TCJA increased first-year bonus depreciation to 100% for qualified property placed in service before 2023. This deduction is scheduled to decrease from 80% to 60% for the 2024 tax year and decreases by 20% each subsequent year through 2027, under the current phase-out schedule. The current bipartisan framework proposes to extend 100% bonus depreciation through 2025, however, currently first-year bonus depreciation is scheduled to sunset after 2026.

Child Tax Credit (CTC): Increased to $2,000 per child and $500 for other dependents under the TCJA, the CTC will revert to $1,000, and the $500 credit will be eliminated in 2026. The phase-out threshold will revert to lower pre-TCJA levels, and the maximum refundable amount will decrease.

Moving Expenses: After the sunset, the rules will become more favorable for taxpayers. Reimbursed moving expenses will no longer be treated as taxable income, and a tax deduction will be allowed for qualifying unreimbursed moving expenses.

GIFT AND ESTATE TAX PROVISIONS:

Current: A 40% tax applies to most transfers exceeding a basic exclusion amount, which the TCJA doubled to $10 million (inflation-adjusted). In 2024, this amount is $13,610,000, with an annual gift tax exclusion of $18,000. The ability to transfer unused exclusions to a surviving spouse remains unchanged.

IN 2026: The basic exclusion amount will decrease to $5 million (inflation-adjusted from 2011), with the GST exemption also decreasing. Unused higher exclusions will not be clawed back, but unused amounts by 2025 will be lost. The highest estate and gift tax rate will remain at 40%, and portability provisions will continue.

State Estate Tax: State laws vary, with some decoupled from federal law. Individual state estate tax rules should be reviewed to determine the impact of federal sunsetting provisions on state transfer tax laws.

CONCLUSION:

With numerous provisions set to sunset at the end of 2025, future legislative changes, elections, and economic conditions could impact the tax landscape. Individuals should plan accordingly, considering potential legislative actions and personal financial situations.

Income Tax Planning: Consider accelerating or deferring income or deductions in 2025 based on expiring provisions.

Estate, Gift, and GST Tax Planning: Be proactive in planning, reviewing existing estate plans, and considering potential changes. The uncertainty of legislative outcomes necessitates careful decision-making, particularly regarding gifting and exemption usage.

The IRS has stated there will be no "clawback" rule for outright gifts made before the sunset of the TCJA. In other words, as long as the gifts are made before the sunset and were not taxable at the time of the gift, then clients will never be taxed on them, even if the exemption amount is lower upon their death.

This means an individual (or a married couple) can avoid taxation on any assets gifted that are in excess of any future reduced exemption amount while also permitting the assets to grow outside of the estate from thereon in.

Here's an example to illustrate this point:

- Let's say an individual makes a gift of $10.46 million today.
- Then, the estate tax exemption sunsets, resulting in a new exemption amount of $6.46 million (the estimated inflation-adjusted amount) in 2026.
- With the no-clawback rule in place, the $4 million in excess of the new exemption (and the growth thereafter) would escape estate taxation.

Transfer techniques often require legal assistance, so it is crucial not to delay discussions and actions until late 2025.

Caution:

1. While we don't encourage unnecessary delay, do not rush into making large gifts to family members or irrevocable trusts without careful consideration. Gifts exceeding the annual gift tax exclusion reduce the do nor's control and make those assets ineligible for a step-up in basis, potentially leading to significant capital gains tax for beneficiaries. Additionally, if the estate tax exemption remains high enough to keep the donor's estate non-taxable at death, gifting may create an unnecessary capital gain tax liability without providing any substantial benefit.
2. Also, there may be some exceptions to "no clawback". For example, if a grantor dies during the term of a Qualified Personal Residence Trust (QPRT) or Grantor Retained Annuity Trust (GRAT), and the asset is brought back into the estate at death, the proposed regulations provide that only the exemption amount available on the date of death will be allowed, regardless of when the assets were gifted to the trust.
3. Although the current law suggests these provisions will end, extender provisions or new legislation could potentially extend, expand, or make some of them permanent. Several bills have been proposed to extend or expand at least some of these provisions. The results of the 2024 election could have a significant impact on future tax laws.

Bottom Line – Do Something: As is always the case, be sure to talk with your own financial and tax advisors to review how the current and future tax environment impacts you, and discuss with them any planning opportunities of which you may take advantage