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Don’t Wait and See What Potential Tax Law Changes May Bring

Key takeaways

- Absent Congressional action, many of today’s tax laws established under the Tax Cuts and Jobs Act of 2017 (TCJA) will automatically expire on December 31, 2025
- High-net-worth individuals and families would be wise to understand the potential implications of the expiring tax provisions of the TCJA and be ready to seize the current planning opportunities they may present
- By staying informed and proactive, individuals and families can position themselves to benefit from current opportunities while preparing for potential changes

As we move into 2025, the tax planning landscape is starting to take shape following last year’s election, which resulted in a Republican President, and Republican control of both the House of Representatives and the Senate.

While new tax legislation is always a possibility with a new administration, the more immediate implication of the election result is its impact on the Tax Cuts and Jobs Act of 2017 (TCJA), enacted during President Trump’s first term. Many of the key provisions of the TCJA are scheduled to expire on December 31, 2025, which means that without any further Congressional action, many of the tax changes ushered in and currently in place will automatically expire, and the tax rules prior to the TCJA will return to their 2017 level.

The TCJA provisions include significant tax reductions, and four possibilities exist for their fate:

- the tax cuts could be made permanent
- the tax cuts could be extended for a set period of time
- the tax cuts could be allowed to expire, and the pre-TCJA tax laws will revert in their places
- selected tax cuts will be extended, perhaps for a certain subset of taxpayers over a range of time, while other provisions will expire

The path of least resistance is the third option: simply letting the tax cuts expire. This would occur automatically if no action were taken or there is political gridlock. However, with Republicans controlling the White House and both chambers in Congress, and their general position on lower taxes, it is possible that many, if not all, of these tax cuts would be extended or made permanent. That said, the Republican majority is slim in both the House (by two votes) and the Senate (by three votes), and any extension of tax cuts will impact the budget and the new administration’s ability to raise funds for other initiatives. For context, according to the U.S. Department of the Treasury, extending the individual and estate tax provisions of the TCJA alone would cost $4.2 trillion over the next 10 years. Therefore, a balancing act is likely needed, and as of now, the outcome remains uncertain.

High-net-worth individuals and families would be wise to understand the potential implications of the expiring tax provisions of the TCJA and be ready to seize the current planning opportunities they may present. It is important to emphasize that, absent Congressional action, many of the tax laws will automatically expire on December 31, 2025. Therefore, for those who took a "wait and see" approach last year prior to the election, the time to evaluate and put a plan in place may be now.

1. Estate, Gift, and Generation-Skipping Transfer (GST) Tax Exemptions

Current landscape and potential changes

The TCJA doubled the federal estate, gift, and generation-skipping transfer (GST) tax exemptions, which are currently $13.99 million per individual or $27.98 million per married couple in 2025. These elevated exemptions are set to revert to approximately half their current levels in 2026 (approximately $7 million per individual or $14 million per married couple) if no legislative action is taken.

Planning considerations

Although the Republicans have historically supported a higher exemption amount or even an elimination of the so-called "death taxes" altogether, there is no certainty that the current historically high levels will be extended or made permanent. Therefore, it would be wise to consider making significant gifts while there is certainty in the law. For those who may be concerned of any potential "clawback" if the exemption does get reduced, the Internal Revenue Service (IRS) has clarified that gifts made under current law will not trigger a "clawback," meaning that if one was to fully utilize the exemption now, before a potential reversion in 2026, there would be no associated tax liability or negative estate or gift tax impact due to the change in law.

When considering significant gifts, there are many strategies to consider. For married couples, the Spousal Lifetime Access Trust (SLAT) continues to offer flexibility while preserving the tax benefit and creditor protection aspects of an irrevocable trust. By including a spouse as a permissible beneficiary of the trust, along with descendants, the SLAT provides a broader range of people who could potentially benefit from the trust's assets, hence offering a greater flexibility for any unforeseen needs to use the trust funds.

If you are considering making a sizable gift and you are married, a potential strategy to "hedge" your bet may be to utilize the full exemption of one spouse, leaving the other spouse's exemption unused and reserved for future gifting. For example, assume a couple collectively has $40 million of current net worth, has not used any of their exemption, and wishes to make a $13 million gift to take advantage of the current environment. The couple could either: (1) each make a $6.5 million gift to two trusts; or (2) have one spouse make a $13 million gift to one trust only. The latter may be a better strategy because if the exemption does drop back to previous levels, then the one spouse who made the $13 million gift would have used all of his or her exemption (with no clawback), and the other spouse would still have approximately $7 million of exemption left for future use. In contrast, had the couple each gifted $6.5 million to a trust, they would likely have minimal exemption left for any future gifting. Also, under this scenario, even if the couple decides not to make any additional gifts during their lifetime, the spouse with the available exemption may utilize the exemption balance at death, or if that spouse was to predecease, the surviving spouse may apply the unused exemption at his or her death under the portability rules. This strategy allows the couple to collectively maximize the current law, while "preserving some dry powder" for future gift or estate purposes.

It is also important to note that, regardless of any potential sunset of the exemption amount, there are inherent benefits of making gifts, including the removal of future income earned or gains from appreciation on the gifted assets from one's estate for estate tax purposes. If you have a rapidly appreciating asset, such as the interest in a business or other types of high potential investments, the earlier you gift that asset, the sooner you can shield the associated income and appreciation from the estate tax. It is important to remember this fundamental concept of gifting and not let any potential change in the law (or lack thereof) be a distraction.

2. Individual Income Tax

Current landscape and potential changes

The TCJA reduced the top federal individual income tax rate for ordinary income from 39.6% to 37%. This is scheduled to expire as of January 1, 2026, at which point the highest income tax rate will revert to its previous high of 39.6%. In terms of capital gains tax, while the rates remain the same with the top long-term capital gains tax rate at 20%, the income bracket was altered by the TCJA such that if the provisions are left to expire, the 20% capital gains rate will start to apply at a lower income threshold, thus increasing the overall tax burden for high-income earners.

Planning considerations

While 2025 income tax rates will be either the same or lower than 2026 levels, it would be wise to consider your timing of income and deductions. In general, when the rates are lower, you would want to accelerate income recognition and delay deductions for future years when rates could be higher. The same concept applies to any long-term tax strategy that may trigger an immediate income tax. For example, if you are considering a Roth IRA conversion, this year would be a better year to execute on that strategy when the income tax rate remains at its current rate. Similarly, if you are looking to capture some gains from your investments, selling those appreciated assets with the current capital gain tax structure may mitigate some of the overall tax burden. Of course, any investment decisions should be made in the context of your overall investment goals and strategy.

3. Individual Income Tax Deductions

Current landscape and potential changes

The TCJA impacted the availability of many income tax deductions.

Standard deduction: For those who do not itemize, the standard income tax deduction was increased to $15,000 for single filers and $30,000 for married couples filing jointly. This will drop to approximately half the amount in 2026, resulting in a lower standard deduction for all.

Mortgage interest and home equity loan deduction: The mortgage interest deduction was capped at $750,000 worth of home loan debt and will revert to $1 million worth of home loan debt in 2026. Homeowners cannot currently deduct interest paid on any home equity loans but will be able to do so again in 2026, up to $100,000 of the home equity loan amount.

State and local tax (SALT) deduction: Current law only allows a maximum deduction of $10,000 of state and local taxes against federal taxable income. These provisions are set to revert to pre-TCJA rules in 2026, where there is no such cap to the deductible amount. This means that those who live in high property and income tax states will be able to benefit from the full deduction, resulting in an overall lower income tax bill. It is important to note that the alternative minimum tax (AMT) exemption is also scheduled to be reduced, which may potentially diminish the actual tax benefit for many taxpayers because those subject to AMT cannot claim a SALT deduction.

Planning considerations

Whether the reversion of the above deductions may be of benefit depends largely on your individual circumstances. In some cases, a reversion to old law could result in a lower overall tax liability, *e.g.*, those living in New York with high state income and property taxes may be able to deduct the full SALT deduction. In other cases, the expiration may create opportunities for future planning, *e.g.*, those who will itemize with a lower standard deduction may want to "bunch" their deductions for later years so to surpass the standard deduction. Since the passage of the TCJA, we have also experienced a change in interest rates, real estate prices, and cost of goods. All of these are factors that one should consider when deciding the need for, and optimal amount of, mortgage and home equity loans. In complex scenarios where the potential benefit and drawback will be heavily situation dependent, the best thing to do is to work with your financial advisor and accountant to ensure that you understand the implications of potential tax law expiration versus the current state, and then make decisions accordingly.

4. Qualified Business Income Deduction (199A Deduction)

Current landscape and potential changes

The TCJA reduced the federal top corporate income tax rate from 36% to 21%. Interestingly, this provision was made permanent and will not expire unlike the other tax provisions described above. However, many businesses are not organized as a corporation and therefore did not benefit from this reduction in corporate tax. In response, Congress created the Qualified Business Income Deduction, otherwise known as the 199A Deduction, to benefit businesses organized as passthrough entities such as a partnership or limited liability company (LLC). Eligible taxpayers can deduct up to 20% of qualified business income (QBI) from their taxable income. The 199A Deduction is scheduled to sunset at the end of 2025. If so, income earned from business endeavors will be subject to varying tax rates depending on the business' organizational form.

Planning considerations

Business owners who organize their businesses as passthrough entities will want to pay close attention to whether this provision will expire, as it will have significant impact on the bottom-line tax treatment of business income. If need be, business owners may reconsider the business entity's structure from the lens of income tax optimization. Entity choices carry impact beyond income taxes, and switching from one type of legal entity to another may also have significant transition and tax implications. This is not a decision to be taken lightly and needs careful evaluation with the help of your business, legal, tax, and financial advisors.

Be Prepared and Ready to Pivot

With the potential for significant legislative changes, 2025 is a critical year for tax planning. By staying informed and proactive, individuals and families can position themselves to benefit from current opportunities while preparing for potential changes. With tax provisions automatically expiring in less than a year's time, the "wait and see" approach may result in delay and opportunities lost. The time to formulate and put a plan in place is now.

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Data source: www.irs.gov