How to Plan For the Sunset of the Tax Cuts and Jobs Act

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On December 31st, 2025, the Tax Cut and Jobs Act (TCJA) – signed by President Donald Trump in late 2017 – will expire. As one of the largest tax reform bills since President Reagan's Tax Reform Act of 1986, it is open for debate whether the TCJA will end up boosting economic growth as much as originally promised. What is not open for debate is that unless Congress acts within the next two years to extend the TCJA (or parts of it), the law will sunset (expire).

The goal of this article is two-fold. First, I will provide information about the expiring tax provisions that are, in my estimation, most relevant to individual investors. Second, I will provide a few strategies that taxpayers may accelerate to take advantage of the current tax law, and/or defer to take advantage of the TCJA sunset in 2026.

Why would parts of the TJCA sunset? Sunset provisions are included in some major legislation, like the TJCA, for three primary reasons: 1) make large or controversial policy changes more politically feasible to pass initially, 2) including an end date for parts of the legislation allows legislators to say the provisions are only temporary or "experimental" when they propose and debate them, and 3) sunsetting provisions allow legislators to project lower long-term costs from a bill and pass it with only a simple majority in the Senate rather than needing a larger consensus. Additionally, the theory is that a future Congress will have a chance to reexamine the impacts of the legislation before the sunset date and decide whether to extend the provisions. Absent any action from Congress and the President, the following are some of the many tax provisions that are set to expire.

Lower Income Tax Brackets

One of the most consequential provisions within the TCJA is the current income tax brackets. To be clear, there are seven tax brackets in both the current law and 2017 law, however it takes *more* income in the current law to reach the progressively higher brackets. For example, in 2017, a married couple earning $235,000 in taxable income (after deductions), would have their last dollar taxed at 33%. In 2024, that same couple earning $235,000 (adjusting for inflation) would have their last dollar taxed at 24%, a reduction of 7% when compared to 2017 levels. If the TCJA sunsets, the brackets will revert to 2017's higher levels and will impact taxpayers across the spectrum (especially middle- and high-income earners).

Here are three considerations a taxpayer may consider:

First, it would be wise to consider a full or partial Roth IRA conversion in 2024 and 2025 at reduced income tax rates. In addition to paying lower taxes on conversion, another benefit would be to start the clock early on the "5-year window." Every Roth IRA conversion has its own 5-year time period until distributions can be withdrawn tax free.

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Second would be to accelerate income in 2024 and 2025 at lower rates, to the extent that there is a choice in the matter. The acceleration of income could be in the form of a bonus taken early, the quickened vesting of RSUs (restricted stock units) under the 83b election, or the installment sale of real-estate property.

The strategies above are best applied by taking advantage of current law and accelerating action now. However, one strategy that could be deferred until after the law sunsets (end of 2025), is the purchase of tax-free municipal bonds. Assuming tax rates pop back to 2017 levels, municipal bonds may become much more appealing to those in the higher tax brackets.

Elimination of "SALT" Deduction (State and Local Tax Cap)

As part of the tax package, a much debated and disputed component is the infamous "SALT" cap. No, with the "SALT" cap, the intention of Congress was certainly not to limit the population's sodium intake! Standing for "State and Local Taxes," the "SALT" cap placed a $10,000 limit on itemized deductions that taxpayers could take when claiming state, local, and property taxes. In high SALT tax states like CA and NY, the cap has been especially harsh, and the hatred of this cap has been ubiquitous across political parties.

Here are two options a taxpayer may consider:

First could be to delay the semi-annual payment of 2025 property taxes until January 2026 (sunset). The deferral and "bunching" of 2025 and 2026 property taxes could result in larger overall property tax deduction in 2026.

Another strategy could be to delay the exercising of corporate NSOs (non-qualified stock options) until January 2026. When an individual exercises their NSO, the "bargain element" – difference between the grant price of the option and fair market value of the stock is taxed as ordinary income tax rates. Waiting for a potentially larger SALT deduction could offset the ordinary income resulting from the NSO exercise.

Increased AMT Exemptions

For a good many taxpayers, the AMT (Alternative Minimum Tax) has been a major bane of their tax liability calculations. For some quick history, the AMT was created in 1969 to ensure that all taxpayers paid a minimum amount of their earnings to Uncle Sam, regardless of tax deductions.

The AMT is essentially a parallel tax calculation with an individual paying the higher of the taxes under the normal or the AMT calculation. The AMT calculation excludes many itemized deductions, including state taxes, medical expenses, mortgage interest, "spread" on incentive stock options, and net operating losses, etc., and then applies an AMT exemption before calculating taxes owed.

With the passage of the TCJA, taxpayers have been able to apply for a much higher AMT exemption. However, the current AMT exemption ($126,500 per married couple) will drop to 2017 levels ($84,500 married couple) or almost 50% if the law sunsets.

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In fact, assuming the TCJA sunsets, the number of people paying AMT will increase 25x from roughly 200,000 to an estimated 5,000,000 in 2026!

Here are three possible strategies to consider:

One strategy would be to exercise ISOs (incentive stock options) in 2024 and 2025 if "in the money" – the strike price is lower than the fair market value of the stock. The "bargain element" or difference between the "grant price" of the option and the "fair market value" of the stock at exercise is added back to taxable income in calculating AMT. Exercising now would take advantage of higher AMT exemptions in 2024 and 2025, and before they are lowered. In addition to taking advantage of currently higher AMT exemption, there is an additional benefit of exercising ISOs before 2026. For example, AMT requires taxpayers to add back deductions (e.g., state and property taxes) to calculate the tax. For people living in high tax states like CA and NY, there is currently less state and property taxes to be added back in 2024 and 2025 than when SALT cap gets eliminated.

A second strategy would be for business owners to accelerate net operating losses (NOL) before sunset NOLs are added back to AMT, but larger exemption in 2024 and 2025 can help mute this.

Lastly, consider the impact of the purchase of private activity bonds in your non-Osborne accounts after 2026. Private activity bonds may trigger AMT in 2026 with a smaller exemption applied. A private activity bond is a bond that is issued by a local or state government (like traditional municipal bonds). However, the purpose is to finance a project for private use (multi-family housing, solid waste disposal, etc.).

Lower Estate Tax and Life-Time Gifting Exemptions

As of 2024, uniform estate and gift tax exemptions are $13.6mil (single) and $27.2mil (married filing joint). Post sunset in 2026, the same exemptions will drop to 2017 levels ($7mil for single filers and $14mil for married couples, and adjusted for inflation).

Therefore, the most obvious strategy is to consider accelerating life-time gifts in 2024 and 2025 and before the uniform gift and estate tax exemptions revert to lower levels. To be clear, any annual gift below $18,000 (per beneficiary) and $36,000 (for couples) does <u>not</u> count towards the lifetime exemption.

For example, a single individual with a $27mil estate can currently gift > 50% of her estate to her children without gift tax ramifications. This is assuming she has not used any of her lifetime exemption nor made any "taxable gifts" above the annual exclusion. The IRS has clarified that even if the exemption amount reverts to prior levels, her 50% gift is fully protected by the $13.61mil lifetime exemption. Should the same individual gift in 2026+ (assuming her estate is the same value), she could be exposed to an additional $2.6mil in taxes.

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Outside of gifting assets directly to family before 2026, there are several estate planning vehicles that one can set up to fund the accelerated gifts: FLPs (family limited partnerships) or IDGT (intentionally defective grantor trusts). Both are complex, so it is advisable to consult with an estate planning attorney.

Lower Mortgage Interest Deductions

One of the drawbacks of the TCJA passage was that it lowered the mortgage interest deduction from $1,000,000 to $750,000. An additional drawback is that the law eliminated the interest deduction on HELOCs (home equity lines of credit) if used for any other purpose besides home improvements. Those who acquired mortgages before December 15th, 2017, were grandfathered in.

Assuming the law sunsets in 2026, the mortgage interest deduction will revert to 2017 levels: $1,000,000 on a first mortgage or an additional $250,000 of interest deductions.

Here are two considerations to take advantage of:

First, it may be worth planning for any large home renovation projects after 2026, assuming you are at the $750,000 cap.

Second, if you plan on consolidating debt, and want to use a HELOC to do so, it may be best to wait until 2026. Currently, the interest on a home equity line is not deductible unless used for home improvement. After 2026, up to $100,000 of HELOC interest will be deductible even if the funds are used for other purposes (e.g., debt consolidation).

While it may be serendipitous to wait anyway to pursue a cash-out refinance (assuming the Federal Reserve lowers rates over the new few years), any borrowing considerations must be considered within the context of current interest rates and cash flow.

While the article discusses some major provisions (within the TCJA) that are most relevant, there are many other provisions that may expire at the end of 2025. For example, the sunset would impact many other provisions, including but not limited to: the child tax credit, charitable tax deduction cap (cash gifts), cap on itemized deductions (“Pease” limitations), qualified business income deductions (QBI), etc. To recap the entire law would prove exhausting to the reader!

Finally, over the next two years, pundits, economists, and analysts (along with your annoying neighbor) will make predictions about the fate of the TCJA. Therefore, I would like to provide you with some closing thoughts. First, it is particularly challenging to predict with great accuracy which of the TCJA provisions will sunset and which will not. Second, while some strategies are mutually exclusive, others are not and can be combined with one another. Last, any strategy will depend on the unique facts and circumstances of each individual and be based on more than just tax savings but encompass other considerations such as cash-flow needs, charitable inclinations and opportunity costs. We encourage you to speak with your Osborne Partners Wealth Counselor and CPA for further information.

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