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Now That We've Seen the Eclipse, It's Time To Plan for the TCJA Sunset

By Erika L. Haupt

As the ball drops in Times Square on December 31, 2024, many of the tax breaks established by the Tax Cuts and Jobs Act (TCJA) of 2017 will disappear. While the TCJA made some permanent tax cuts, a number of tax cuts and deduction limitations will sunset at the end of 2025 and revert to pre-TCJA levels.

What the U.S. Tax Code will look like on January 1, 2026 largely depends on who wins the White House in 2024 and which party controls Congress. Considering the uncertainty, it is important to plan now for potential tax law changes that will become effective unless Congress acts before January 1, 2026. Here are some significant provisions set to expire next year:

1. Income Tax Rates

The TCJA lowered personal income tax rates across the board and restructured bracket ranges. Other than for taxpayers who were at the 10% rate and the 35% rate, all income tax rates decreased when the TCJA became effective. The top rate dropped from 39.6% to 37%, the 33% bracket fell to 32%, the 28% bracket to 24%, the 25% bracket to 22% and the 15% bracket to 12%.

Should the TCJA changes to personal rates sunset, brackets will revert back to 39.6%, 35%, 33%, 28%, 25%, 15% and 10%. Depending on the bracket, taxpayers will pay from 1% to 4% more in Federal personal income taxes if the TCJA tax cuts are not extended or made permanent.

2. Standard Deduction

For tax years beginning January 1, 2018 and ending December 31, 2025, the standard deduction is nearly double for all taxpayers. Before the TCJA, the standard deductions were $6,350 for single filers, $9,350 for heads of household and $12,700 for married taxpayers filing jointly. After the TCJA, standard deductions jumped significantly. The standard deductions for the 2023 tax year are $13,850 for single or married filing separately, $27,700 for married filing separately and surviving spouses, and $20,800 for heads of household.

In part, the rationale for increasing the standard deductions was to simplify the tax filing process for many taxpayers. Rather than itemize, it is estimated that 90% of taxpayers now opt to take the standard deduction as increased by the TCJA. The higher deduction is especially attractive to retired taxpayers and those without a mortgage.

The TCJA was criticized by those in the nonprofit world because they believed the higher standard deduction discouraged charitable giving. For taxpayers who are not otherwise philanthropically inclined, why make a charitable contribution if there is no income tax benefit? Unless the TCJA standard deductions are made permanent, we should see an uptick in taxpayers who itemize to lower the income tax bill.

3. State and Local Tax Limitation

Also affecting the number of taxpayers who itemize, the TCJA limits the state and local income tax ("SALT") deduction to $10,000. Before the TCJA, there was no limit on the deductions allowed for property, income and sales tax paid to the extent a taxpayer itemized deductions. Should the SALT deduction cap be lifted as a result of the TCJA sunset, that combined with a lower standard deduction will cause many more taxpayers to itemize beginning in the 2026 tax year.

4. Mortgage Interest Deduction

For mortgage debt incurred after December 15, 2017, the TCJA permits taxpayers who itemize to deduct interest paid on the first $750,000 of such debt secured by a first or second residence ($375,000 for married taxpayers filing separately). No deduction is allowed for interest paid on new or existing home equity indebtedness not used for purposes related to the property securing the mortgage. On January 1, 2026, the $750,000 limit will return to $1 million, and interest paid on the first $100,000 of home equity debt, regardless of the purpose for the loan, will be deductible.

5. Qualified Business Income Deduction

The TCJA permanently lowered the corporate tax rate to 21%, but that rate does not apply to pass-through entities, the income of which is taxes to the owners. To address the disparity between taxation of owners of corporations and owners of pass-through entities, the TCJA created a qualified business income ("QBI") deduction. Using the QBI deduction, owners of pass-through entities, including partnerships, limited liability companies, S corporations and sole proprietors, may deduct up to 20% of their QBI subject to certain limitations based on W-2 wages paid, unadjusted basis of qualified property and taxable income. It is set to expire in 2025, so qualifying entities should take advantage of this tax savings opportunity while they still can.

6. Estate Tax Exemption

The TCJA doubled the estate and gift tax exemption for individuals as adjusted for inflation. In 2017, the exemption was $5.49 million. After the TCJA, the exemption in 2018 rose to $11.18 million. This year, the exemption is $13.61 million for each taxpayer, which means a married couple may give away $27.22 million during their lifetime or at death before a 40% gift or estate tax is imposed.

If the increased exemption is allowed to sunset on December 31, 2025, it will be cut in half. For example, if the exemption remains at $13.61 million per taxpayer in 2025, TCJA sunset would cut it to $6.805 million in 2026 ($13.61 million for a married couple). To "bank" the increased exemption now, many taxpayers are transferring assets to family members or trusts for family members. The IRS issued final regulations in November 2019 confirming that there will be no "clawback" should the exemption be permitted to sunset. In other words, if a taxpayer uses $13.61 million of exemption in 2024 and it reverts to $6.805 million in 2026, no part of the $13.61 million gifted will be subject to tax in the taxpayer's estate simply because the exemption went down following the date of the gift. In April 2022, the IRS issued proposed regulations placing some limitations on the anti-clawback rule, but those regulations are not final and, even if finalized, do not provide for unlimited clawback on all gifts.

For help with tax planning, please contact any one of Roetzel's tax attorneys.

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