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“Sunset” of The Tax Cuts and Jobs Act in 2026—Will it Bring Endless Night, or a New Dawn?

Washington, DC, has oft been described as a “black hole,” usually as a cosmic metaphor for its insatiable appetite for federal spending. To outside observers, however, the “information loss paradox” that attends celestial black holes likewise applies to the mysteries of legislative logic beyond the event horizon of the Capital dome. It is through this lens then, that some semblance of order may be brought to a pending solar event closer to home—the “sunset” of the Tax Cuts and Jobs Act of 2017.

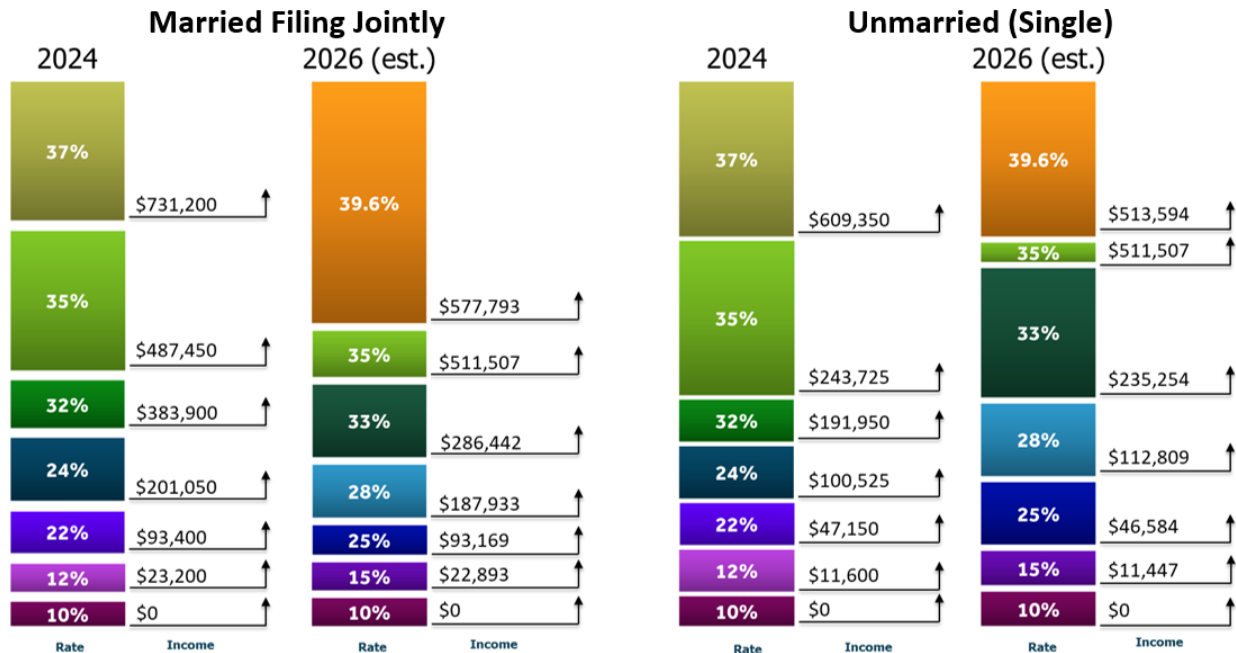
Sunset in a Static Universe

The Tax Cuts and Jobs Act of 2017 was enacted in December 2017 during the first year of the Trump administration, effective for tax years 2018 and beyond. The bill lowered individual tax rates and expanded brackets, while increasing the standard deduction to provide broad based income tax cuts for most individual taxpayers. In exchange for rate reductions, many common deductions were eliminated or reduced—primary among them was the state and local income tax (SALT) deduction, capped at \$10,000 per return (or half that amount for married filing separately). Additionally, the corporate income tax rate was dramatically reduced from 35% to 21%. To create a measure of tax parity for pass-through business entities (S Corporations, partnerships, LLCs, and sole proprietorships), a new provision was included in the law for a “qualified business income” (QBI) tax deduction of up to 20% of such income. Lastly, the law doubled the amount exempt from estate, gift, and generation skipping transfer tax to \$11.2 million per person (\$13.61 million per person as of 2024) from a previous amount of \$5.49 million.

Individual income tax rates and rules

Married individuals will generally face an across-the-board income tax rate increase coupled with lower bracket thresholds for higher rates, while many single filers will also experience a tax increase (though some may see a slight reduction depending on income level).

Married Couple Filing Jointly and Single Income Tax Rates and Brackets



The standard deductions as of 2024 stand at \$29,200 married filing jointly and \$14,600 single. In 2026, those amounts will revert to an estimated \$15,500 married and \$7,800 single.

Many repealed or modified deductions will likewise return, including:

- **Unlimited state and local income tax deduction** (from current \$10,000 limit);
- Increase in **mortgage interest deduction** debt limit to \$1 million (from current \$750,000 acquisition debt limit), plus a return of home equity interest deduction; and
- **Personal Exemption** for each taxpayer and dependents (approx. \$4,950).



Other individual items impacted by sunset include:

- Reduction of Adjusted Gross Income (**AGI**) **deduction limit** for charitable **cash** contributions to **50%** from current **60%**.
- Reduction in **AMT exemption** as well as income level for AMT phase-out (exposing many taxpayers to alternative minimum tax);
- Return of Pease limitations on itemized deductions (for higher income individuals); and
- Expanded **1031** “like-kind exchange” benefits beyond real property.

The vast majority of individuals would likely experience an income tax increase under sunset—e.g., assume a married couple filing jointly with \$100,000 combined adjusted gross income:

Married Couple Filing Jointly (no dependents, don't itemize)	2024	2026 (estimated brackets)
Adjusted Gross Income	\$ 100,000	\$ 100,000
Standard deduction	29,200	15,500
Personal exemptions	-	9,900
Taxable income	70,800	74,600
Federal income tax	8,032	10,045

Somewhat counterintuitively, though, high income earners in states with high state income tax rates may actually experience a slight tax reduction:

Married Couple Filing Jointly (no dependents, NY state residents)	2024	2026 (estimated brackets)
Adjusted Gross Income	\$2,000,000	\$2,000,000
Standard deduction / Itemized*	29,200	178,514
Personal exemptions**	—	—
Taxable income	1,970,800	1,821,486
Federal income tax	655,322	654,078

* NY State income tax of \$178K

** Phased out due to income.

Note that capital gains tax rates and brackets, as well as the 3.8% Net Investment Income Tax thresholds were not impacted by TCJA, and thus continue apace.



Section 199A Qualified Business Income (QBI) tax deduction

Millions of small business owners may currently exempt up to 20% of their business income from federal taxation under the QBI deduction, reducing the top effective rate on business income to 29.6%. Under sunset, such provision is repealed in its entirety.

Note that the (C Corp) corporate tax rate reduction avoids the automatic sunset provision, escaping the gravitational pull of the Senate’s budgetary rules. The sunset of individual rates and “permanence” of corporate rates was by design—the architects of the TCJA were bound by budgetary limits in its passage, though the future extension of individual rates was viewed as enjoying much wider potential political support when it comes up for renewal. Time, of course, will tell.

Estate and gift tax exemption amounts

The Tax Cuts and Jobs Act of 2017 significantly increased the federal estate and gift tax exemption amounts—the amount of wealth that can be passed to heirs free of estate or gift taxes. An individual can pass \$13.61 million free of such taxes in 2024. Starting in 2026, however, that amount will automatically be reduced to approximately \$7 million per person. As a result, estates that did not expect to be subject to estate taxes may see significant exposure arise instantly. For example:

	2024	2026
Combined estate (married)	\$20,000,000	\$20,000,000
Combined exemptions	27,220,000	14,000,000
Federal estate tax	—	2,400,000

Preservation of estate and gift tax exemptions in light of sunset has been a focal point of planning discussions due to the short-term window of opportunity potential sunset offers. While the sunset of individual rates offers few planning maneuvers beyond acceleration of income (where available) and possible Roth IRA conversions, wealth transfer tax benefits through concerted planning can be very significant if undertaken in time.

Exogenous Pressures on TCJA Sunset

As sunset in 2026 is well over a year away, one might believe there is ample time for Congress to broker a thoughtful compromise that provides a requisite timetable to plan for any changes from current law. Recent history, of course, indicates such hope would be misplaced.

The prospects for any broad-based action on the sunset of TCJA prior to the November election is as probable as discovering a wormhole to a distant galaxy in one's basement—theoretically possible, but practically speaking non-existent. To most observers, the results of the election will determine the trajectory and prospects for any specific legislation addressing sunset; however, it remains doubtful that the election will be completely dispositive in any event.

- It is unlikely either political party obtains large majorities in Congress and/or secures unified control in Washington—as a result, some degree of compromise will likely be needed in order to move any legislation forward.
- That being said, agreement between the major parties is extremely hard to come by, and acrimony is likely to deepen in light of what is expected to be a very contentious presidential election.
- Nor does unified control guarantee success, as the Biden administration's attempt at broad based tax changes under its Build Back Better (BBB) proposals ultimately failed.

Deficits-Entitlements

The sunset of certain TCJA provisions is necessitated due to the potential impact on the federal deficit. Since passage, though, federal deficits have surged to levels not seen since World War II (as a percentage of GDP), while projected annual deficits are expected to exceed \$1 trillion for the foreseeable future.

Mandatory federal programs such as Social Security, Medicare, and Medicaid are consuming an ever-larger share of federal outlays, and still face solvency issues of their own. Deficit spending has also increased the overall cost of interest on the federal budget, at a time when interest rates have crept steadily higher above the long-term low interest rate environment experienced for many years. The extent to which any semblance of fiscal sanity is allowed to take root in DC will therefore have a significant impact on which provisions under TCJA become the focal point of discussion.

Most prognosticators are of the opinion that a complete extension of TCJA in its entirety is unlikely, although a total sunset is equally improbable. The Republican members of the tax writing committees have generally expressed their desire to fully extend TCJA. Democrats, however, are operating from the BBB template, which intends to raise taxes on

corporations, high income earners, and large estates. The parties may be a universe away from each other, but an Einstein-Rosen bridge may yet appear to join the two. The extension of TCJA for income earners below the top marginal bracket, as well as an extension of the §199A QBI in some form is likely to garner broad based support. The potential tradeoff, however, is likely to be an increase in the corporate tax rate, as well as higher income, capital gains, payroll, and estate taxes on the wealthy, however that category of taxpayer is defined.

Planning Considerations in Light of Estate Tax Sunset

A reduction in the estate tax exemption amount under sunset could be accompanied by additional changes to the estate tax rules, especially if bargained in exchange for more broadly applicable income tax extensions. The Build Back Better legislation proposals from 2021 provide a vivid framework for the Democratic party's position on wealth taxes, as long gestating ideas were finally introduced as legislative text.

The "For the 99.5% Act" and the Sensible Taxation and Equity Promotion (STEP) Act

Prior Democratic estate tax proposals (within the For the 99.5% Act that may yet be revived) included a reduction of the estate tax exemption to **\$3.5 million per person**, coupled with a reduction of the gift tax exemption to **\$1 million per person**.

- The proposal likewise increased the applicable estate tax rate on a graduated basis to rates as high as 65%.
- Additionally, certain common and widely used wealth planning arrangements were targeted including:
 - **Valuation discounts** for lack of control and marketability for any assets that are not used in the active conduct of a trade or business;
 - **Grantor Retained Annuity Trusts (GRATs)** designed to avoid gift taxes;
 - Irrevocable **Grantor Trusts** (also known as Intentionally Defective Irrevocable Trusts [IDITs]) as effective wealth transfer tools;
 - **A limit on the effective duration of the Generation Skipping Transfer (GST) Tax exemption;** and
 - **A cap on the total annual exclusion gifts a donor is permitted to make in trust.**

An additional proposal under the STEP Act would eliminate the unlimited step up in basis for property that is includible in one's taxable estate. The bill would tax unrealized capital gains of assets transferred by gift (in trust or otherwise) or at death. Additionally, the STEP Act would tax unrealized gains of assets held in trust every 21 years. A \$1 million exemption



would be available to offset any realization upon death (with a \$100,000 exemption for lifetime transfers), and the tax would be payable in installments over a 15-year period for gains attributable to specific illiquid assets such as a family farm or business. Additionally, transfers to spouses or contributions to charity would generally be excluded from realization.

Lifetime gifting of excess exemption

In consideration of potential sunset and other possible changes to estate and gift tax rules, larger estate owners may consider the transfer tax benefits of large lifetime gifts. Gifts to existing or newly established grantor trusts should likewise be grandfathered for purposes of any subsequent changes in grantor trust rules that may be imposed. The tax savings available from the current excess exemption, both in the near term and in the future, can be illustrated as follows:

	Gift Excess Exemption	No Gifting	Potential Tax Savings from Gifting
Total exemption	\$ 13,610,000	\$ 13,610,000	
2024 Gift	\$ 13,610,000	—	
Additional taxable estate (2026)	—	\$ 15,755,276	
Exemption in 2026	—	7,000,000	
Estate tax in 2026	—	3,502,111	\$ 3,502,111
Additional taxable estate (2034)	—	\$ 21,113,577	
Exemption in 2034	—	8,040,000	
Estate tax in 2034	—	5,229,431	\$ 5,229,431
Additional taxable estate (2044)	—	\$ 34,391,792	
Exemption in 2044	—	9,790,000	
Estate tax in 2044	—	9,840,717	\$ 9,840,717

These results are further magnified where valuation discounts can be employed through non-managing interests in LLCs, limited partnership interests in FLPs, or non-voting shares of closely held stock. Many individuals hesitant to make large lifetime gifts solely for future estate tax savings may employ **Spousal Lifetime Access Trusts (SLATs)** to include a spouse as a beneficiary (and possibly trustee), as well as give a trust protector or third-party broad power to amend a trust or exercise a power of appointment over the trust if tax laws or family circumstances change.

The excess exemption under current law likewise applies to **Generation Skipping Transfer (GST)** tax exemption, offering the ability to fund dynastic trusts and avoid additional transfer taxes as wealth passes to subsequent generations.

To realize transfer tax benefits from excess gifts prior to 2026, individuals must gift amounts that exceed the future estate tax exemption—gift exemption comes from the “bottom” of the exemption pile rather than the top. For couples that are hesitant to make two such sizable gifts, it may make sense to consider a gift by one spouse (generally to a SLAT) of one spouse’s “bonus” exemption.

Lastly, many states impose a state estate tax, although most lifetime gifts under the federal exemption avoid state estate taxes in their entirety (New York state has a 3-year lookback rule, while Connecticut is the only state that imposes a state level gift tax). For this reason, effective planning with federal exemptions may avoid or reduce the impact of state estate taxes as well.

Irrevocable life insurance trusts remain attractive planning tool

In many cases, individuals who can benefit from asset shifting remain reluctant to do so considering the loss of direct access to and control over gifted property. Irrevocable life insurance trusts (ILITs) continue to offer an alternative to complex and potentially cumbersome wealth shifting strategies. Life insurance established outside of the taxable estate generally offers simplicity, predictability, and a hedge against a constantly changing tax landscape. While the TCJA sunset will be addressed in some form or fashion in 2025, this is far from the last time that income or transfer taxes will be subject to major modification.

In cases where survivorship (2nd to die) life insurance is considered primarily for estate tax planning, a Survivorship Standby Trust (SST) arrangement may be suitable to consider for personal accumulation and estate tax efficiency. Under an SST arrangement, the spouse with the shorter life expectancy will normally own the survivorship life insurance policy during his lifetime, with the contract passing to an irrevocable trust at death for the benefit of the surviving spouse, removing the death proceeds from the taxable estate at that point.

Estate tax in unexpected places

Estate tax sunset may have surprise consequences in other scenarios as well. Notably, a recent 8th Circuit Court of Appeals decision¹ held that company owned life insurance will increase the value of a business interest for estate tax purposes, even if such proceeds are obligated to fund a buy-sell agreement. A previous case out of the 11th circuit² has been long observed as the template for how a properly established buy-sell arrangement can apply company owned life insurance proceeds to a purchase obligation without increasing the value of the business artificially. The US Supreme Court has agreed to resolve the circuit split, however, company owned life insurance buy-sell arrangements should likely be reviewed in light of potential estate tax consequences (due to sunset or otherwise) as well.

Hope for the Best, Plan for the Worst

While it is possible that TCJA is addressed in early 2025, it is far more likely that negotiations will drag on until much later into the year. Prior instances of sunset legislation in fact have not been resolved until the latest possible moment, including resolution early in the following year. Early engagement on planning risks and opportunities is crucial.

- First and foremost, it is important to note that proper planning takes time—attorneys must be engaged, documents drafted, assets identified, family businesses recapitalized, valuations obtained, and timely transfers effected. The planning process can take several months if not longer, and 2025 is likely to be a very busy time for professional advisors. Undue delay will result in lost access to the best advisors and potentially slipshod implementation, increasing the risk of mistakes and scrutiny on planning arrangements.

¹ *Connelly v. United States*, 70 F.4th 412 (8th Cir. 2023) (affirming district court's grant of summary judgement to the IRS (*Connelly v. United States*, 4:19-cv-01410-SRC (E.D. Mo. Sep. 21, 2021))).

² *Estate of Blount v. C.I.R.*, 428 F.3d 1338 (11th Cir. 2005).



EYE ON CONGRESS

- For those who are strongly considering asset shifting arrangements in light of sunset, but still hopeful for an extension, initial planning steps can be implemented while retaining the option to shift assets at the latest possible moment with execution documents at the ready. As one advisor opined, taxpayers can 'build the house, but wait to move the furniture in.'
- Alternatively, individuals with little time for entity formation, appraisals or recapitalizations of existing entities can consider establishing trusts and gifting easily valued property (e.g., cash or securities), then subsequently swap or sell discountable assets to the trust, perhaps with the inclusion of a defined value clause to guard against gift tax challenges.

As federal deficits collapse infinitely inward, the singularity at DC's core distorts the very fabric of space and time. Forgotten tax laws suddenly reappear, while presidential contests repeat in a seemingly endless time loop. And while escape may not be possible, pro-active planning can put individuals in control over their own fate, rather than subject to the whims of the cosmos.

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