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# The Washington Report

## Wealth Transfer Edition

This Washington Report is prepared exclusively for Finseca Influencer members by Todd Steinberg, Partner and Jennifer Smith, Senior Counsel at Loeb & Loeb.

## COVERING ALL BASES: TAX REFORM PROPOSAL "CHEAT SHEET"

**MARKET TREND**: While final tax legislation may generate beneficial outcomes, the current uncertainty is difficult to navigate for both clients and their allied advisors.

**SYNOPSIS**: The recently-passed Congressional budget "blueprint" paves the way for Congress to draft ambitious tax reform legislation based on the President's agenda, but it offers few details, leaving the specifics of which proposals will be implemented, and how, to be determined. Currently, the key reform proposals include: (1) "permanent" extension of many of the expiring provisions of the Tax Cuts and Jobs Act, (2) repeal of the federal estate tax, (3) an increase or a repeal of the limitation on the deduction for state and local income taxes, (4) taxation of carried interest as ordinary income rather than long-term capital gain, and (5) elimination of income taxes on Social Security benefits, tip income, and overtime pay.

**TAKE-AWAYS**: As we wait for legislative details, advisors should (i) focus on flexible planning approaches, such as including contingency provisions in documents that are triggered by the laws applicable at a client's passing, and/or making transfers to "QTIPable" trust or via installment sales rather than gifts, (ii) not let tax uncertainty derail important non-tax reasons for client planning, such as creditor protection and business succession, (iii) keep in mind that state tax planning will become even more important, and may even increase if states seek to increase revenue by raising state tax rates, and (iv) stay informed and keep in touch with clients to help manage the uncertainty and be best prepared to respond once we have more details regarding the direction of final tax legislation.

On April 10th, the House passed the Senate's amended version of the budget "blueprint," paving the way for Congress to draft legislation implementing the President's ambitious tax reform agenda. The budget, however, offers only a general framework for the new tax legislation, based on target goals for overall spending and tax cuts, leaving much to determine regarding which proposals will be implemented and how. As the current uncertainty is difficult to navigate for both clients and their advisors, below is a "cheat sheet" highlighting the key reform proposals and potential options for specific client planning in the interim.

## CHEAT SHEET ON TAX REFORM PROPOSALS

1. **Permanent Extension of the Tax Cuts and Jobs Act (TCJA).** A main component of the Administration's tax agenda is to make "permanent"[1] the changes enacted by the TCJA in 2017, many of which are set to expire at the end of 2025 and revert to pre-TCJA law. Below is a quick comparison of provisions under a TCJA extension versus a TCJA sunset:

| | TCJA Continues | TCJA Sunsets |
|---|---|---|
| **Gift, Estate and Generation Skipping Transfer (GST) Taxes** | Exemptions projected at $14.3 million for 2026, indexed for inflation. **Subject to potential repeal (see below).* | Exemptions drop to projected $7.2 million (based on $5 million, as increased for post-2011 inflation).[2] |
| **Individual Income Tax Rates** | Rates stay at 10%, 12%, 22%, 24%, 32%, 35% and 37%, with higher thresholds at each bracket (39.6% applies at $771,550 for joint filers). | Brackets increase to 10%, 15%, 25%, 28%, 33%, 35% and 39.6% and apply at lower thresholds (e.g., 39.6% reached at $615,100 for joint filers). |
| **Long Term Capital Gains (LTCG) and Qualified Dividends** | Rates stay at 0%, 15% and 20%, tied to standalone LTCG brackets. | Rates remain at 0%, 15% and 20%, but are tied to ordinary income brackets (e.g., 20% LTCG rate applies if income falls within 39.6% bracket). |
| **Standard Deduction and Personal Exemption** | Standard deduction at $15,425 for single filers and $30,85 for joint filers in 2026. No personal exemptions. | Standard deduction drops to $8,350 for single filers and $16,700 for joint filers. Personal exemption of $5,300 returns. |
| **Cap on State and Local Income Tax (SALT) Deduction** | $10,000 maximum deduction remains for state and local income, sales and property tax for single and joint filers. **Subject to proposed repeal (see below).* | SALT cap expires, allowing larger itemized SALT deductions but potentially offset by return of "Pease" limitation and pre-TCJA alternative minimum tax (**AMT**) rules (see below). |
| **Cap on Mortgage Interest Deductions** | $750,000 limit on mortgage debt eligible for interest deduction, and not deduction for interest on home equity lines. | Mortgage debt limits increases to $1,000,000, and interest on up to $100,000 of home equity debt is itemized deduction again. |
| **Miscellaneous Itemized Deductions** | No miscellaneous itemized deductions permitted (such as for investment management and tax preparation fees). | Miscellaneous itemized deductions permitted to the extent they exceed 2% of adjusted gross income (**AGI**). |
| **Charitable Income Tax Deduction** | Limits deduction to 60% of AGI for gifts of cash to public charities. | Reduces limit to 50% of AGI. |

[1]The goal of "permanent" extensions of expiring tax provisions needs to be understood in the context that: (i) any bill or law that addresses these issues is likely to be passed under the Reconciliation Process, so that the law technically cannot take effect for more than 10 years or must sunset at such time, and (ii) future Congressional action could always re-enact tax law changes to re-impose or re-instate certain tax provisions, including, but not limited to, the imposition of the federal estate tax, gift tax and/or GST tax.

[2]Pursuant to the TCJA, inflation adjustments to various tax provisions, including transfer tax exemptions and income tax brackets, became based on "chained" CPI-U, generally resulting in lower adjustments than the CPI-U. The "Chained" CPI-U provisions do not sunset and thus will remain the basis for annual inflation indexing.

| | TCJA Continues | TCJA Sunsets |
|---|---|---|
| **Pease Limitation** | Repealed | Limitation restored. Reduces itemized deductions by 3% of specified AGI threshold (inflation indexed). Reduction capped at a maximum of 80% of a taxpayer's itemized deductions. Primarily affects higher income taxpayers. |
| **AMT** | Higher AMT exemptions ($88,100 for single filers and $137,000 for joint filers in 2025) and increased income levels for phase out ($626,350 for single filers and $1,252,700 for joint filers in 2025). Largest AMT preference items (like SALT deduction) remain repealed or scaled back. | Return to reduced AMT exemption (projected at $54,300 for single filers and $84,500 for joint filers) and phase out income levels. ($120,700 for single filers and $160,900 for joint filer). Application of AMT will likely eliminate the potential benefits of SALT cap removal. |
| **Qualified Business Income (QBI) Deduction (aka §199A Deduction)** | Qualifying business owners of pass-through entities (such as S corporations, partnerships, LLCs) can deduct up to 20% of QBI. | Deduction eliminated, meaning some pass-through entities will be subjected to a higher rate of tax than C corporations. |
| **Other Business Tax Provisions** | Most TCJA provisions that affect C corporations, including 21% rate for C corporations, do <u>not</u> sunset. | The bonus depreciation deduction began being phased out in 2023 and will be fully phase-out by 2027. **Subject to re-enactment by tax reform proposal, noted below.* |

With respect to the expiring business provisions under the TCJA, the Administration would like to restore the full bonus depreciation deduction described above, avoiding the scheduled 2027 phase out. In addition, the Administration would return the limit on net interest expense to 30% of income before interest, taxes, depreciation, and amortization (as opposed to the less generous current limit based on income before interest and taxes), and maintain the deduction and effective tax rates on Global Intangible Low-Taxed Income (GILTI) and Foreign-Derived Intangible Income (FDII) at their current levels (which are set to rise in 2026).

Certain estimates indicate that, if all provisions of the TCJA expire, households in the top 1% will pay an additional 3.1% of their income in taxes.[3]

[3] Comfort Oshagbemi and Louise Sheiner, "Commentary: Which provisions of the Tax Cuts and Jobs Act expire in 2025?", September 5, 2024 (brookings.edu/articles).

2. **Estate Tax Repeal.** Senate Majority Leader John Thune (SD) has endorsed including a full repeal of the estate tax as part of the upcoming tax reform legislation, with many Republican Senators and House members voicing support. For example, the Death Tax Repeal Act introduced in the Senate in February 2025 would permanently eliminate the federal estate and GST tax, impose a 35% gift tax with a permanent lifetime gift tax exemption of $10 million, as adjusted for inflation ($13.99 million in 2025), and retain the step-up in basis to fair market value for assets held at death. As history has shown, however, "permanency" is a relative term when it comes to tax law changes, and any repealed estate tax could be reinstated based on future changes in Congress or the White House,

3. **Increase or Repeal of SALT Cap**. The Administration would like to eliminate the cap on SALT deductions, allowing deduction itemizers to take a full deduction for their state and local taxes beginning in 2026. Other proposals have included increasing the cap or allowing only state property taxes (and not income or sales taxes) to be deducted without a cap. These proposals would primarily benefit higher income earners in high tax states, who are more likely to itemize.

4. **Treatment of Carried Interest as Ordinary Income.** Treatment of Carried Interest as Ordinary Income. The Administration has proposed taxing the carried interest typically received by private equity and hedge funds managers as compensation for their services at ordinary income rates rather than the lower LTCG rates. This proposal would effectively tax the carried interest on an equivalent basis with wage compensation, potentially as early as 2026. This change would require fund manager to promptly review and consider restructuring their overall compensation and profits interests in the funds they manage. It also would affect prior wealth transfer tax planning that was implemented to shift the benefits of these favorably taxed carried interests, particularly if grantor trusts were used in that prior planning, since the client, as grantor, would be required to pay the higher taxes on the trust's income. In these cases, the proposal's enactment could result in some clients wanting to terminate grantor trust status, as the payment of higher taxes may run counter to a client's longer-term wealth transfer objectives.

5. **Elimination of Income Taxes on Specific Benefit/Income Categories.** The Administration has proposed eliminating income taxes on the following specified types of benefits/income:

    - **Social Security Benefits.** The Administration has suggested exempting Social Security benefits from income taxation. Currently, beneficiaries with combined incomes above $25,000 ($32,000 for joint filers) pay tax on a portion of their benefits based on their overall income levels, with a maximum of 85% of Social Security benefits taxable on beneficiaries with combined incomes of $34,000 or more ($44,000 for joint filers). Although there are no specific details yet, it seems plausible that this tax benefit would be phased out for individuals above certain income thresholds.

    - **Tips.** The Administration has proposed ending income taxes on tip incomes. Currently, about 2.5% of the workforce receive tips as a portion of their income. Any such legislation, however, would need to be crafted carefully to avoid potential abuse, as it could incentivize businesses and employees to structure more of their compensation as "tip-based" wages. Payroll (i.e., FICA) taxation likely would still apply to reported tips.

- **Overtime Pay.** Under current law, overtime pay is subject to income and payroll taxes like other wage income. The Administration has proposed exempting overtime pay from income taxation, although, as with tips, it likely would remain subject to payroll taxes.

## WHAT TO DO WHILE WE WAIT

**Focus on Flexible Planning.** In this environment, flexible planning is at a premium. Potential approaches that can be implemented now include the creation of a simple, minimally funded irrevocable trust agreements now, which would be ready to use if and as needed to respond quickly to final tax legislation (see discussion in Washington Report #01.23.25). Other flexible planning options include:

- **Consider Incorporating Contingency Provisions.** Flexibility can be enhanced by giving independent trust protectors, trustees or other fiduciaries broad powers to modify trust agreements to adapt to subsequent tax and other legal changes, such as estate tax repeal. Estate planning documents also can include various contingency provisions based on the laws applicable at the time of death (advisors active around 2010 may recall similar planning to address the one-year estate tax repeal). For instance, formula bequests based on estate and GST tax exemption amounts could be made contingent based on the existence of a federal estate tax law or drafted with caps so that a specified maximum amount will pass to designated beneficiaries (e.g., a surviving spouse) if the exemptions increase or are eliminated. These contingency provisions must be carefully crafted, however, to limit practical ambiguities in the desired results and possible subsequent estate tax inclusion risks.

- **Sell Rather than Gift Assets.** Clients who are contemplating or in the process of planning with irrevocable trusts, particularly for non-tax reasons (such as business successor planning) may decide to sell rather than gift assets to the trust in exchange for an installment note or SCIN. The sale can be unwound or the gift completed later, depending on the most desirable course of action based on final tax legislation.

- **Make Gifts to "QTIPable" Trusts.** 2025 gifts can be made to a lifetime qualified terminable interest (QTIP) trust for the sole benefit of a spouse. The QTIP trust election would not need to be made until filing of the 2025 gift tax return, which would not be due, with extension, until as late as October 2026. The delay provides time for the client to decide if a QTIP election will make sense under finally-enacted tax legislation. For example, if both estate and gift taxes are repealed, the beneficiary-spouse could release his or her interest in the QTIP trust, terminating the trust and potentially allowing the assets to be distributed to descendants (or trusts for their benefit). If only the federal estate tax is repealed, a QTIP election can be made to prevent application of any federal gift tax. In either case, the trust agreement also can give discretionary powers to an independent trustee to permit distributions of some or all of the trust assets to the trust beneficiaries and terminate the trust, if such discretionary distributions and/or termination would be in the best interests of the beneficiaries.

- **Review Conversion to SCINs.** Converting existing promissory notes to self-cancelling installment notes (SCINs) may make sense for clients with shorter life expectancies. The repayment obligation under a SCIN terminates automatically upon the seller/lender's death during the note term, and generally the note charges a higher interest rate and/or has a higher principal amount than a standard promissory note to compensate for the cancellation feature. If there is concern that a client could die before the repeal of the estate tax or an increase in the estate tax exemption above the client's net worth, this option may be worth further analysis and discussion.

**Remember Non-Tax Reasons for Planning.** Creditor protection, legacy/investment management and business succession all remain critical reasons for trust planning and should not be overlooked or forgotten in the flurry of analyzing potential tax reform.

**Keep State Taxes on the Planning Radar.** Several states still impose state estate taxes, and we may see increases in other state taxes to generate additional revenue in response to changes in government spending, federal funding, and economic conditions. Irrevocable trusts, including non-grantor, completed gift, and incomplete gift trusts, will continue to serve important roles in this required state and local tax planning.

**Stay Informed and Touch Base with Clients.** Much is in flux in the current tax and economic environment, and political and legislative agendas can move quickly with the Republican-controlled White House, Senate and House. Finseca is continuously monitoring these issues and will keep members apprised of notable activities to help in responding. It is also important to reach out to clients regularly to let them know that you are not only tracking changes, but also are available to discuss recent developments, including a review of their current plans and potential options to deal with the uncertainty. Staying up to date and in touch will be the best tools for quickly adjusting and implementing client planning in response to prospective tax legislation.

## TAKE-AWAYS

As we wait for legislative details, advisors should (i) focus on flexible planning approaches, such as including contingency provisions in documents that are triggered by the laws applicable at a client's passing, and/or making transfers to "QTIPable" trust or via installment sales rather than gifts, (ii) not let tax uncertainty derail important non-tax reasons for client planning, such as creditor protection and business succession, (iii) keep in mind that state tax planning will become even more important, and may even increase if states seek to increase revenue by raising state tax rates, and (iv) stay informed and keep in touch with clients to help manage the uncertainty and be better prepared to respond once we have more details regarding the direction of final tax legislation.