ADVANCED PLANNING

Insights & Ideas

Preparing for the Sunsetting of the Tax Cuts and Jobs Act

The only constant is change. The majority of the provisions of the Tax Cuts and Jobs Act (TCJA) were designed to be temporary, and they are slated to disappear at the stroke of midnight on December 31, 2025. The chance for an extension of these provisions will likely hinge on Republicans winning the Presidential Race, taking control of the Senate, and maintaining control of the House. Even then, the legislation would have to pass with the backdrop of over $34 trillion in U.S. debt, and a debt to GDP ratio over 130%.

Some of the most impactful changes to the TCJA provisions are as follows and will be discussed throughout this paper:

- The unified gift & estate tax exemption drops in half
- Standard deductions drop nearly in half for many taxpayers
- The child tax credit drops in half
- The personal exemption returns
- The $10k limit on state and local taxes (the SALT deduction) will be removed
- Income tax rates increase for most taxpayers
- The Alternative Minimum Tax (AMT) returns
- The elimination of the 20% qualified business income deduction
- The personal exemption phaseout returns
- The Pease limitation on itemized deduction returns

The Unified Gift and Estate Tax Exemption Dropping by Half

The current exemption amount is $13.61M per taxpayer in 2024. It will climb higher in 2025, accounting for the customary inflation adjustment, but it is then slated to drop in half in 2026 to what many estimate to be around $7M. The ability to leverage the largest exemption in U.S. history is thus likely short lived, and taking advantage of it before it runs out may pay huge dividends, as this may turn out to be a once-in-a-lifetime opportunity to pass significant wealth to children, grandchildren, and other loved ones in a tax-efficient manner.

If no planning is done, and the death occurs after 2025, when the exemptions is likely to have dropped to about $7M, the maximum estate tax savings available will be $2,800,000 ($7M at a 40% rate). However, a taxpayer taking advantage of the current $13.61M exemption today will save a minimum of $5,444,000 in taxes ($13.6M at a 40% rate). That is an additional $2,644,000 of saved taxes going to family members and loved ones, as opposed to the IRS. We say minimum because not only is the $13.6M gift not subject to estate tax, but neither is any of the growth on the $13.6M. In addition, the exemption amount will be higher in 2025 due to the customary inflation adjustment, providing an additional ability to gift that increased amount without a transfer tax.

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Keep in mind, this is accounting for a single taxpayer; for a married couple, they both may be able to leverage today's higher exemption amount, doubling the potential benefit before the opportunity disappears in 2026. However, for married couples who are not in a financial position that allows both spouses to maximize their gift exemptions, they should consider having at least one of them maximize their exemption. As 2026 approaches, attorneys are likely to be very busy working with their top clients; procrastinating may lead to a situation where you may not be able to get the planning done in time.

For a long time, the big question was, "If we use today's higher exemption amount to make gifts during our lifetime, what happens if the exemption amounts are lower at the time of my death? Would the IRS treat the excess as part of the estate?". Phrased another way, would the excess be clawed back into the estate? Thankfully, on November 26, 2019, the IRS adopted a special rule known as the anti-clawback rule, confirming that it would not in fact bring these gifts back into the estate. In April of 2022, this rule was further clarified in proposed regulations, confirming that true completed lifetime gifts, where the taxpayer does not retain possession and enjoyment of the transferred asset, would not be clawed back into the estate.

These types of sizable gifts are generally done through trusts. However, irrevocable non-grantor trusts that have their own tax identification number, and their own responsibility to pay taxes, reach the highest tax rate of 37% after reaching only $15,200 of taxable income in 2024. When it comes to an irrevocable non-grantor trust, the tax liability now rests with the trust, not an individual. Unfortunately, tax rates for non-grantor trusts are much higher at any given income level than for individuals, as shown below:

2024 Trust Federal Income Tax Rates:

Taxable Income	Marginal Rate
$0 - $3,100	10%
$3,100 - $11,150	24%
$11,151 - $15,200	35%
Over $15,200	37%
Top income tax with the Medicare Surtax is 40.8% on income over $15,200	

A tax-deferred annuity may provide relief from this problem if the trust is considered to be acting as an agent for a natural person(s). This is generally the case when the trust has natural persons as trust beneficiaries, and a trust beneficiary is the annuitant. A tax-deferred annuity can provide control over when the income will be taxed, and assuming the trustee can distribute to the beneficiaries, potentially avoid trust tax rates altogether. Gains inside the annuity will not be taxed until they are withdrawn. When they are withdrawn, if the trustee can then distribute those gains within the same taxable year to the trust beneficiary, the distributed gains will be taxed at the beneficiary's personal tax rate and not the likely higher trust tax rate. Furthermore, based on prior rulings from the IRS, when an annuity contract is held by a non-grantor trust which is being terminated, it is possible to complete a non-reportable transfer of the ownership of the annuity from the trust to the individual who is the contract annuitant and trust beneficiary, which can provide a powerful multi-generational planning opportunity.

Increasing Income Tax Rates

Many will see an increase in their tax rates, including the return of the 39.6% top tax rate.

Filing Single		
Income	2024 Tax Rate	2026 Tax Rate
$0 - $11,600	10%	10%
$11,601 - $47,150	12%	15%
$47,151 - $100,525	22%	25%
$100,526 - $191,950	24%	28%
$191, 951 - $243,725	32%	33%
$243,726 - $609,350	35%	35%
Above $609,350	37%	39.6%

Married Filing Jointly		
Income	2024 Tax Rate	2026 Tax Rate
$0 - $23,200	10%	10%
$23,201 - $94,300	12%	15%
$94,301 - $201,050	22%	25%
$201,051 - $383,900	24%	28%
$383,901 - $487,450	32%	33%
$487,451 - $731,200	35%	35%
Above $731,200	37%	39.6%

As an example, if a couple filed jointly and earned $200,000 of taxable income today, it would yield a tax bill of $34,106, but after the sunsetting, the same level of taxable income would yield an estimated tax bill of $39,410[1]. Given the likelihood that most will creep into higher tax rates in 2026, we may want to consider the potential benefits of accelerating income into the 2024 and 2025 tax years, including the potential benefits of completing Roth conversions in 2024 & 2025.

This concept can be coupled with the idea of tax bracket management: converting enough each year to stay within the current tax bracket without moving into the next bracket. If one is diligent with this and does it year after year, they will successfully increase the portion of their assets that represent potentially tax-free Roth IRAs, while doing it on a tax-managed basis.

This may also help in the retirement years by not just lower potential taxes, essentially our younger selves helping our older selves have less of a tax burden, but also potentially helping to manage the cost of Medicare and the taxation of Social Security, as these benefits are determined at least partly by how much income we have in retirement, and tax-free distributions from Roth IRAs do not add to income.

An additional side benefit is that Roth IRAs do not have a required minimum distribution obligation, and thus we have more flexibility regarding when we take and do not take distributions from Roth IRAs. Furthermore, these ideas may help the next generation, as the Secure Act accelerates the recognition of tax on retirement dollars into a short 10-year period for most beneficiaries, rather than spreading the tax liability over a lifetime. Traditional IRAs and pre-tax retirement plans can leave a large tax burden for the next generation which can cause tax bracket creep, as often, the death occurs when the next generation is likely to be in their highest earning years. However, leaving behind a Roth IRA is generally tax-free to the next generation, and they will have at least another 10 years to grow the assets on a tax-free basis.

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[1] Assume taxable income of $200,000 after standard deductions and exemptions. Applies proposed tax rates to 2024 income brackets.

Standard Deduction Dropping by Nearly Half

Approximately 90% of Americans take the standard deduction, which reduces the amount of income on which you are taxed, meaning come 2026, the vast majority of Americans will not only see their tax rates go up, but more of their income will be taxable income to boot, as the standard deduction is slated to drop by nearly half. The standard deduction for 2024 is $14,600 for single tax filers, and $29,200 for joint tax filers. These deductions will increase in 2025 due to the customary inflation adjustment. However, they are then estimated to drop to about $8,300 for single tax filers, and $16,500 for joint filers[2]. As a result, we will likely see many more itemize their deductions in 2026, instead of simply taking the standard deduction.

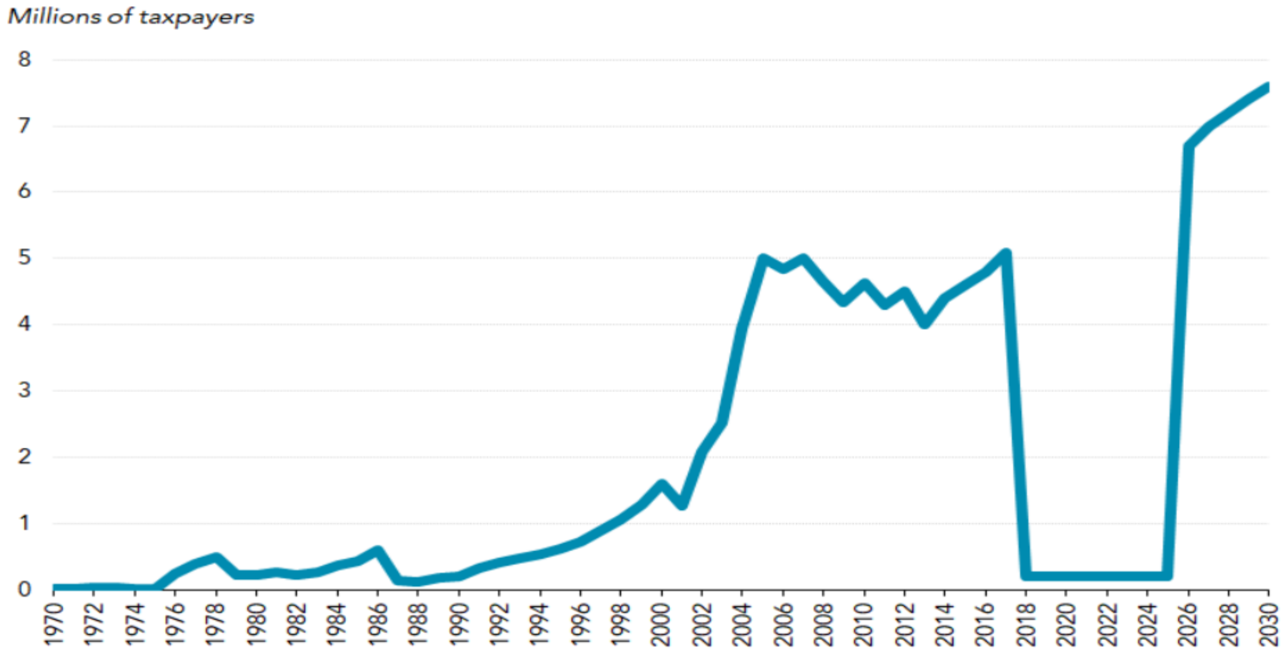
Alternative Minimum Tax (AMT) Will Make a Comeback

The AMT system requires some taxpayers to calculate their tax liability twice. First, under the ordinary income tax system, then again under the AMT system. They then pay whichever is the highest. The AMT has fewer preferences and exemptions, and different rates than the ordinary system. AMT removes deductions for items such as state & local taxes, real estate taxes, personal property taxes, & personal exemptions. Often, incentive stock options can trigger AMT, as under AMT the hypothetical profit on incentive stock options are added back into the calculation.

The current exemption amount for 2024 is $133,300 for joint filers and $85,700 for single filers. However, once your AMT income hits the phase-out threshold, your AMT exemption begins to phase out at 25 cents for every dollar over the threshold. In 2024, the phaseout starts at $1,218,700 of taxable income for joint filers, and $609,350 for single filers. We will see the sunsetting of today's higher AMT exemptions and phaseouts, causing AMT to roar back into the picture.

The estimated exemptions amount for 2026 is $109,900 for joint filers, and $70,600 for single filers, and the phaseout is estimated to start at $209,300 for joint filers, and $157,000 for single filers. In fact, as a result of this change, it is estimated that the number of taxpayers affected by AMT will rise from approximately two hundred thousand in the period 2018 through 2025, to approximately 7.6 million in 2026, as shown in the chart below. It is estimated the number will reach 9.7 million by 2032.[3]

[2] (CATO Institute, 2026 Tax Increases in One Chart, Major Tax Changes in 2026, 12/13/2023)
[3] Urban Brookings Tax Policy Center Microsimulation Model (versions 0304-3, 1006-1, 0613-1 0319-2)



Source: Urban-Brookings Tax Policy Center Microsimulation Model (versions 0304-3, 0308-4, 1006-1, 0613-1, 0319-2); Harvey and Tempalski (1997); private communication with Jerry Tempalski; and SOI Division of Internal Revenue Service.
Note: Data includes those with direct AMT liability on Form 6251, those with lost credits, and those with a reduced deduction for years 2001-2030. Tax units that are dependents of other taxpayers are excluded from this analysis.

Child Tax Credit Dropping by Half

The child tax credit allows low and moderate-income families to reduce their tax liability dollar-for-dollar by up to $2,000 for each qualifying child. The child tax credit is only for children under the age of 17 as of the last day of the year. It is slated to drop from $2,000 to $1,000 and is also scheduled to phase out at much lower levels of income. Under today's laws, it is not phased out until a single filer reaches $200,000 of Modified Adjusted Gross Income (MAGI), and not until a joint filer reaches $400,000 of MAGI. However, after the sunsetting, it will phaseout for a single filer at $75,000 of MAGI, and for a joint filer at $110,000. The credit is reduced by $50 for every $1,000 your MAGI is above the limit. Thus, once you are $20,000 above the limit the $1,000 credit would be eliminated (20 X $50).

Elimination of the 20% Qualified Business Income Deduction for Passthrough Businesses

Owners of passthrough businesses, such as partnerships and S corporations, as well as sole proprietorships, may currently claim a deduction of up to 20% of Qualified Business Income. Beginning in 2026, this deduction will no longer be available.

Some additional changes include the annual deduction limit for cash contributions to public charities decreasing from 60% to 50% of adjusted gross income (AGI). Moreover, the Pease limitation will come back, reducing itemized deductions for high income earners by 3% of their excess over the applicable AGI threshold. However, the maximum loss is 80% of the itemized deductions. The threshold is estimated to be $408,600 of AGI for joint filers, and $340,500 for single filers. The Pease limitation applies to charitable donations, the home mortgage interest deduction, state and local tax deductions, and miscellaneous itemized deductions. However, it does not apply to medical expenses, investment expenses, gambling losses, and certain theft and casualty losses.

On a more positive note, we will get the personal exemption back, but with its customary phase-out for those with higher levels of income. Additionally, the $10,000 limit on state and local taxes (the SALT deduction) will be removed, but with the customary Pease limitation for those with higher levels of income, and the limiting effects of AMT. However, it is likely many will start itemizing deductions again rather than just taking the standard deduction. Let's talk about each of these.

Personal Exemptions Will Come Back

A personal exemption, which was eliminated by the Tax Cuts and Jobs Act, is an amount that you can deduct from your taxable income for yourself and for each of your dependents. The personal exemption will come back and is estimated to be about $5,300[4]**.** However, the personal exemptions phase-out will also come back, reducing personal exemptions by 2% for every $2,500 over the applicable threshold. Thus, it is reduced 100% once the threshold is exceeded more than $122,500. The estimated personal exemption phase-out in 2026 is estimated to be about $408,600 for joint filers, and $340,500 for single filers. Thus, personal exemptions will completely be wiped out at approximately $531,100 for joint filers, and $463,100 for single filers.

The $10,000 Limit on State and Local Taxes (the SALT deduction) Will be Removed

The Tax Cuts and Jobs Act capped the deductible amount for state and local taxes at $10,000. For individuals who were residents in states with high income tax rates and property tax rates, this limitation significantly increased their federal income tax burden. However, after 2025, this limitation will expire, allowing greater benefit from deducting taxes, including real estate taxes, state or local income taxes, and personal property taxes. However, this may be limited for many due to the Pease limitation or due to AMT taxation.

Some additional changes include an increase in the mortgage interest deduction from $750,000 back to the $1 million limit. This deduction will also be expanded to include up to $100,000 in home equity debt., and the 2% miscellaneous deduction will come back for those who itemize for items such as investment fees, tax prep fees, and loss on annuities.

Prudential is Here to Support You

Before the sun goes down on the Tax Cuts and Jobs Act, you should consider discussing these scheduled tax changes listed below with your clients and exploring all available options to help them chart a course for successful navigation based upon their unique circumstances.

Prudential's Advanced Planning Team is available to support you as you address the spectrum of client needs. For further discussion of HSAs, healthcare costs, or any advanced strategy, contact the team at 888-425-1022.

[4] CATO Institute, 2026 Tax Increases in One Chart, Major Tax Changes in 2026, 12/13/2023)

	Today	2026 Estimated
Unified Gift & Estate Tax Exemption	$13.61M	$7M
Income Tax Rates	Maximum Tax Bracket 37%	Maximum Tax Bracket 39.6%
Standard Deduction	$14,600 Single & $29,200 Joint	$8,300 Single & $16,500 Joint
Child Tax Credit	$2k	$1k
Child Tax Credit - Phaseout	$200k Single & $400k Joint	$75k Single & $110k Joint
Qualified Passthrough Business Income Deduction	20% Deduction	0%
Personal Exemptions	$0	$5,300
Personal Exemptions Phaseout	Suspended	Reinstated
State and Local Tax Deductions (SALT)	Capped at $10k	No Cap
Alternate Minimum Tax (AMT) Exemption	$85,700 Single & $133,300 Joint	$70,600 Single & $109,000 Joint
AMT Phaseouts	$609,350 Single & $1,218,700 Joint	$157,000 Single & $209,300 Joint
Pease Limitation	Suspended	Reinstated

References:

CATO Institute: 2026 Tax Increases in One Chart, Major Tax Changes in 2026, 12/13/2023

AMT Calculation: *2024 – After TCJA: Exemption:* $133,300 (Joint), $85,700 (Single) Phase Out: $1,218,700 (Joint), $609,350 (Single)

2018 – Prior to Considering TCJA (IRS Rev. Proc 2017-58 Oct. 19, 2017): Exemption: $86,200 (Joint), $55,400 (Single) Phase Out: $164,100 (Joint), $123,100 (Single)

2024 – Prior to Considering TCJA (Applying Same Inflation Adjustment): Exemption: $105,000 (Joint), $67,500 (Single) Phase Out: $200,000 (Joint), $150,000 (Single)

2026 – Prior to Considering TCJA (Assuming 2.3% Increase – White House Economic Analysis): Exemption: $109,900 (Joint), $70,600 (Single) Phase Out: $209,300 (Joint), $157,000 (Single)

Pease Limitation Calculation: *2018 – (IRS Rev. Proc 2017-58 Oct. 19, 2017):* Threshold: $320,000 (Joint), $266,700 (Single) *2024* – (22% Increase): Threshold: $390,400 (Joint), $325,400 (Single) *2026 – (Assuming 2.3% Increase – White House Economic Analysis):* Threshold: $408,600 (Joint), $340,500 (Single)

Personal Exemption Phaseout Calculation: *2018 – (IRS Rev. Proc 2017-58 Oct. 19, 2017):* Threshold: $320,000 (Joint), $266,700 (Single) *2024 – (22% Increase):* Threshold: $390,400 (Joint), $325,400 (Single) *2026 – (Assuming 2.3% Increase – White House Economic Analysis):* Threshold: $408,600 (Joint) – Completely Phased out by $531,100 - $340,500 (Single) – Completely Phased out by $463,000

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