

Sunset of the TCJA Tax Reforms

PRESENTED FOR

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The Issue

- The Tax Cuts and Jobs Act (TCJA) of 2017 made changes to numerous parts of Federal tax law. Several of these changes include a “sunset” provision—without an affirmative act by Congress, they will expire on December 31, 2025.
- The following key provisions for high-net-worth individuals are scheduled to sunset:
 - **The estate and gift tax exemption amount.** The TCJA doubled the exemption amount from \$5 million to \$10 million (\$13.99 million in 2025 after annual inflation adjustments), meaning very few estates have been subject to the estate tax. The sunset would reduce the exemption by half for 2026 (in the range of \$7 million).
 - **The standard deduction and personal exemption.** For income taxation, the TCJA increased the standard deduction and eliminated the individual personal exemption. The sunset would revert the standard deduction to 2017 amounts and bring back the personal exemption.
 - **The Pease limitation.** The TCJA repealed the Pease limitation, which was a phaseout of itemized deductions applied to individuals whose adjusted gross income (AGI) exceeded \$261,500 in 2017 (\$313,800 for married couples). The sunset would reinstate the Pease limitation for tax years beginning in 2026 (adjusted for inflation).

The Impact

- Those who want to pass on wealth have been able to rely on the higher exemption amounts and other changes under the TCJA. If those provisions are allowed to expire, wealthy individuals (including those who may reach that category by 2026, thanks to potential asset appreciation) will be affected. In particular, many more estates will potentially be subject to the estate tax again.
- While it is less likely now that we have one-party control of both Congress and the White House, Congress could let these provisions expire (for example, if it becomes too costly to extend or make them permanent).
- Now is the time to work with financial professionals and legal counsel to carefully review financial and estate plans and explore planning strategies (such as those that follow) to protect assets and minimize taxes.

Strategy: Tax Minimization with a Bypass Trust

- Married couples enjoy the unlimited marital deduction for the gift and estate tax (for U.S. citizens only). In addition, the portability of the deceased spouse’s unused exclusion amount means the surviving spouse may be able to utilize the full amount of the lifetime exclusion, potentially resulting in a larger tax-free estate for the surviving spouse. However, the estate will be fully taxed at the death of the second spouse.
- In preparing for the potential sunset of the higher exclusion amount, married couples might consider the bypass trust (also known as the credit shelter trust) to pass assets to beneficiaries at the death of a first spouse, making full use of the applicable credit amount at each spouse’s death to avoid estate taxation at the second spouse’s death.

- With a bypass trust, there will be no federal estate taxes due at the death of the first spouse. The will divides the estate into two parts:
 - One part, equal to the applicable exclusion amount, is placed in the trust. It is sheltered from tax by the first spouse's applicable exclusion. The trust may provide liberal benefits to the surviving spouse but will bypass the surviving spouse's estate at death.
 - The other part either passes outright to the surviving spouse (sheltered from tax by the unlimited marital deduction) or is placed in a marital deduction trust for the spouse's benefit.
- At the second death, the surviving spouse can use the applicable credit amount (plus any available deceased spousal unused exclusion amount) to shelter additional assets.

Strategy: Estate Reduction through Annual Gifts

- Taking advantage of the gift tax annual exclusion is a simple and effective way to reduce the size of the estate (and therefore any gift and estate tax) while keeping assets in the family or with friends. This tool can be a particularly effective way to pass significant assets to family members as part of a continuing series of annual gifts.
- Each individual is allowed to give up to \$19,000 (in 2025) to an unlimited number of donees without incurring the federal gift tax. The annual exclusion for gifts from a donor spouse to a non-citizen spouse is \$190,000 (in 2025).
- Married couples may also make use of gift-splitting, whereby both spouses can join together in a present-interest gift to a third party, even if the gift property comes entirely from one spouse. The spouses must file a gift tax return to elect gift-splitting.
- In addition, gifts beyond the annual exclusion amount made before January 1, 2026, will not be subject to the reduced exemption amount, and the IRS has stated that for large, lifetime gifts made now, it will not "claw back" taxes once the exemption amount is reduced.

Strategy: Estate Reduction through Charitable Gifts

- Another way to reduce the size of the estate is by making charitable gifts. For those who are so inclined, gifting assets accomplishes a philanthropic goal, removes assets from the estate, and often comes with tax benefits for the donor.
- There are numerous ways to make tax-efficient gifts, including the following:
 - **A charitable gift annuity (CGA).** In exchange for the donor's gift of cash, real estate, securities, or assets, a charitable organization agrees to make fixed payments to the donor and/or someone else (two people maximum) for life—payments based on the amount of the gift, the age of the person(s) receiving the payments, the number of annuitants, and whether the start of payments is immediate or deferred. Part of the gift qualifies for an immediate tax deduction, and the payments are treated as part tax-free return of principal, part long-term capital gain, and part ordinary income.
 - **A charitable remainder trust (CRT).** A CRT combines an income for the donor and/or other beneficiaries (for life or for a period of up to 20 years) with a charitable gift of whatever remains in the trust at the end of the payment period. While more complex than a CGA, it also offers more flexibility to meet a variety

of planning goals. It qualifies for an income tax deduction for the present value of the anticipated remainder interest.

- **A charitable lead trust (CLT).** This trust makes payments to charity first, then distributes the remainder to named beneficiaries (typically family members). This minimizes estate and inheritance taxes for the beneficiaries.
- **A donor-advised fund (DAF).** A DAF removes assets from the estate and puts them in a managed account. This qualifies for a current charitable income tax deduction, even though the donor can recommend grants to qualifying charities at any point in the future. The donor may also choose to name a charitable organization as successor to the DAF upon the donor's death.

Strategy: Preparation for Potential Estate Tax with an ILIT

- Taxpayers likely to be impacted by the estate tax once the exemption amount is reduced might consider an irrevocable life insurance trust (ILIT).
- An ILIT is an irrevocable trust that holds a life insurance policy on the life of the grantor or the grantor's spouse. The grantor completely gives up all rights in the policy transferred to the trust and retains no right to revoke, terminate, or modify the trust in any material way.
- A taxpayer typically uses an ILIT to help meet estate liquidity needs, avoid any estate tax on the death proceeds, and provide protection from creditors at death. It can also help provide for the income needs of survivors after any liquidity costs have been satisfied, as the ILIT beneficiaries are typically the grantor's family members.
- Using the life insurance proceeds in the ILIT, the trustee is often authorized to purchase estate assets in an arms-length transaction, providing the estate with much-needed cash for taxes and other expenses payable shortly after death.

The Bottom Line

If Congress allows the TCJA tax provisions to sunset at the end of 2025, it will certainly affect those with significant estates. Now is the time to consider strategies to minimize the impact of the returning income, gift, and estate tax laws.

Summary

The Impact of the Scheduled Sunset of TCJA Tax Reforms

The Tax Cuts and Jobs Act (TCJA) of 2017 made numerous positive changes to tax law but also included a “sunset” provision under which several changes would revert starting in 2026. Perhaps most importantly, the gift and estate tax exemption amount, which doubled under the TCJA, is scheduled to drop from its current \$13.99 million (in 2025) to somewhere in the \$7 million range. Taxpayers with sufficient assets to be impacted by the estate tax (or who expect to be in this position by the end of 2025) should review their financial and estate plans and consider strategies to minimize the potential tax impact if Congress does not take action to prevent the sunset.

Minimize Taxes with a Bypass Trust

At the death of the first spouse, the surviving spouse can often get the estate free of tax thanks to the unlimited marital deduction and portability of any unused exclusion amount. At the death of the surviving spouse, though, the larger estate may be subject to significant tax. A bypass trust may help.

At the death of the first spouse, the will directs assets equal to the applicable exclusion amount into the trust, while the rest passes to the surviving spouse tax free under the marital deduction. The trust can provide liberal benefits to the surviving spouse. At the second spouse’s death, trust assets go to named beneficiaries, while other assets in the second spouse’s estate may be fully or partially sheltered by the applicable exclusion amount.

Reduce the Estate Value by Gifting Assets

Gifts can reduce the estate tax by reducing the value of a taxable estate while passing wealth to family members, meeting philanthropic goals, qualifying for a charitable income tax deduction, or even creating a new income stream for retirement. And remember—the IRS will not “claw back” taxes on gifts made through 2025 once the exemption amount is reduced.

- **Annual gifts** reduce the taxable estate while keeping assets in the family using the annual gift exclusion. Taxpayers can give \$19,000 (in 2025) tax free to an unlimited number of recipients. A spouse can give \$190,000 (in 2025) tax free to a non-citizen spouse. Married couples can use gift-splitting to combine their annual gift tax exclusion amounts, even if the gift assets come entirely from one spouse.
- **A charitable gift annuity (CGA)** combines a gift to a qualified charity with a fixed lifetime income for the donor and/or someone else (two people maximum). The gift qualifies for an income tax deduction, and payments are tax-advantaged.
- **A charitable remainder trust (CRT)** also provides an income for the donor and/or other named beneficiaries for life or a term of up to 20 years, with the charity receiving all remaining assets at the end of the trust term.
- **A charitable lead trust (CLT)** makes payments to the charity first, then distributes the remainder to family members or other named beneficiaries, minimizing estate and inheritance taxes for the beneficiaries.
- **A donor-advised fund (DAF)** removes assets from the estate now and lets the donor recommend gifts later.

Prepare for the estate tax with an ILIT

Taxpayers who are most likely to be impacted by the estate tax once the exemption amount is reduced might consider an irrevocable life insurance trust (ILIT). An ILIT can help meet estate liquidity needs, avoid any estate tax on the death proceeds, and provide protection from creditors at death. It can also help provide for the income needs of survivors after any liquidity costs have been satisfied, as the ILIT beneficiaries are typically the grantor's family members.

Conclusion

Now is the time to review financial and estate plans and explore strategies for minimizing taxes if the TCJA provisions are allowed to sunset at the end of 2025.

SUNSET OF THE TCJA TAX REFORMS

Example



Lola, age 76, had a long, successful career as a bioengineer. During her life, she accumulated a significant estate worth \$12 million (after expenses and charitable gifts) in the hopes that she'd be able to pass it on to her daughter, Mila. If Lola dies in 2025 in a state with no estate taxes, and with the full estate tax exemption of \$13.99 million available for her estate, Lola's estate would not be subject to estate tax and the full \$12 million would pass to Mila.

However, if Lola passes away in 2026, after the TCJA sunset, the estate tax exemption could be in the \$7 million range. Beyond that, her estate would be subject to the highest marginal estate tax of 40%. Without planning for this change, the sunset would result in a significant negative change in the amount going to her daughter.

	2025 (Before Sunset)	2026 (After Sunset)
Gross Estate	\$12,000,000	\$12,000,000
Estate Tax Exemption	\$13,990,000 (actual)	\$7,000,000 (estimate)
Approximate Federal Estate Taxes Owed	\$0	\$2,000,000
Approximate Amount Passed to Heirs	\$12,000,000	\$10,000,000

This information is not intended to be a substitute for specific individualized tax or legal advice. We suggest that you discuss your specific situation with a qualified tax or legal advisor.

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