Election 2024 – Tax Policy Outlook

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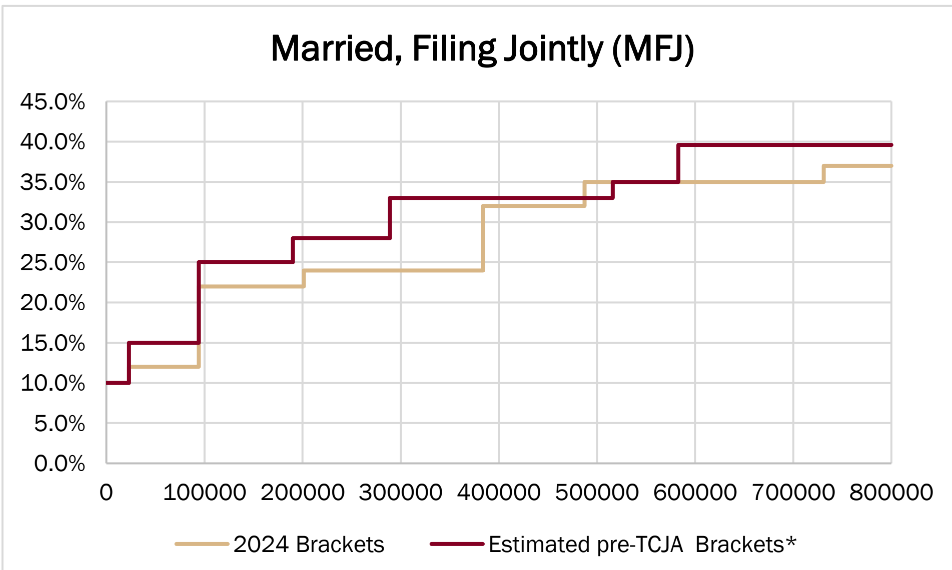
All elections are important, but the results of the 2024 election could be especially so from a tax perspective. This is because nearly all of the individual tax provisions in the Tax Cuts and Jobs Act of 2017 (TCJA), the most significant tax legislation in decades, will sunset at the end of 2025 unless Congress acts. Congress's failure to extend the TCJA would result in higher taxes for most Americans. The Republican presidential candidate, former President Donald Trump, has indicated that he would make the TCJA permanent. The Democratic presidential candidate, current Vice-President Kamala Harris, has stated that she would also seek to make the TCJA permanent for the majority of Americans (those making less than $400,000). However, beyond extending the TCJA for at least some taxpayers, the candidates' tax plans differ considerably, and the outcome of the 2024 election will have a significant impact on future U.S. tax policy.

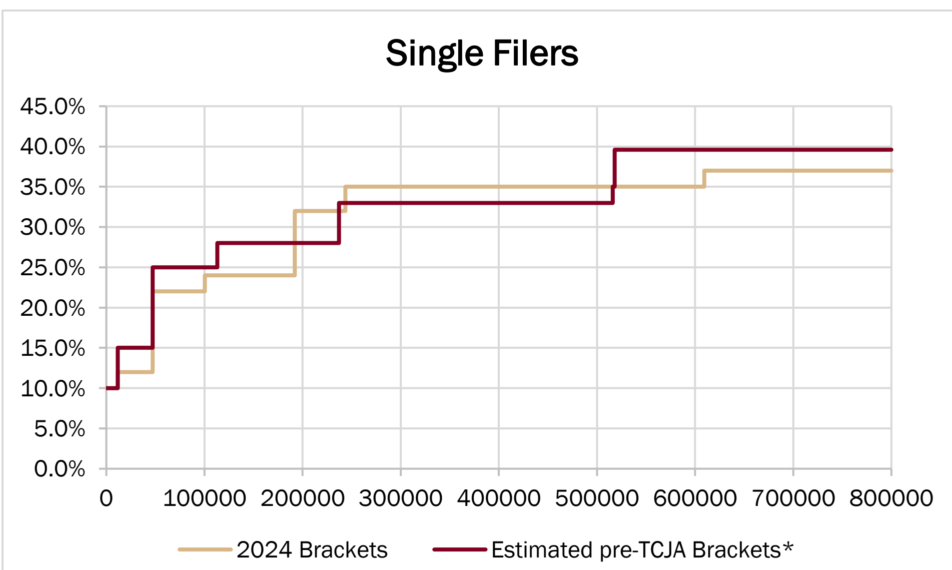
This article 1) provides a summary of the key TCJA provisions set to expire, 2) highlights each presidential candidate's tax plan, 3) offers perspective on what might actually happen based on history, and 4) provides some planning strategies to consider in advance of the potential sunset.

Expiring TCJA Provisions

There are several significant TCJA tax provisions set to expire at the end of 2025 unless Congress acts to extend them. Although some households paid less tax under the pre-TCJA rules, the TCJA reduced taxes for the majority of Americans, with the average effective tax rate across all households dropping from 20.7% in 2017 to 19.4% in 2018 (the first year the TCJA tax provisions went into effect). The TCJA also doubled the estate tax exemption, allowing significantly more families to transfer assets to younger generations without being subject to the estate tax. In addition to reducing taxes on individuals, TCJA also reduced the corporate tax rate from 35% to 21% and allows owners of passthrough businesses such as partnerships and S corps to deduct up to 20% of their qualified business income. Below is an overview of the key individual tax provisions that are set to expire at the end of 2025:

Tax Rates: Individual income tax will revert to the pre-TCJA rates and brackets with the top marginal rate going from 37% to 39.6%. As mentioned above, certain taxpayers would have paid less tax under the pre-TCJA rules. One example is single filers with $200,000–$500,000 of taxable income who have higher marginal rates under the TCJA tax brackets than they had under the pre-TCJA brackets. However, the majority of taxpayers have lower tax rates based on the TCJA brackets. The following charts illustrate the tax rates under the 2024 TCJA brackets compared to the inflation-adjusted 2017 pre-TCJA brackets, which is what the law will revert to unless Congress acts to extend the individual income tax provisions of the TCJA.





* Estimates based on the 2017 brackets adjusted for inflation to 2024

<u>**Standard Deduction:**</u> The standard deduction will be approximately cut in half (the 2024 standard deduction is $29,200 for MFJ and $14,600 for single filers). However, a decreased standard deduction would be offset by the return of personal exemptions (the pre-TCJA personal exemption was $4,050 for each filer and dependent but was phased out when adjusted gross income (AGI) reached $156,900). Households with a large number of dependents are another example of taxpayers who may have paid less tax under the pre-TCJA rules as a result of the personal exemptions. A decreased standard deduction would also be offset by the return or expansion of certain itemized deductions including the following:

- Miscellaneous itemized deductions will return subject to a 2% AGI floor (this includes deductions for investment fees, tax advice fees, and certain job-related expenses);
- The personal casualty loss deduction will be available to more taxpayers (this deduction is currently only allowed for losses resulting from a Federally declared disaster);
- The moving expense deduction will be available to more taxpayers (this deduction is currently only available to active-duty members of the Armed Forces);
- Mortgage interest will be deductible for up to $1 million of the mortgage amount (this deduction is currently limited to $750,000 for most mortgages acquired after 2017);
- HELOC interest will be deductible on loans of up to $100,000 (this deduction is currently allowed only to the extent the funds are used to buy, build, or substantially improve a home secured by the loan); and
- The state and local tax (SALT) deduction limitation will go away (this deduction is currently limited to $10,000 for state and local taxes).

<u>**Child Tax Credit:**</u> The child tax credit will be cut in half (the current credit amount is $2,000 per qualifying child), but more importantly, the AGI phase-out will drop to $110,000 for MFJ or $75,000 for single filers (currently the phase-out begins at $400,000 for MFJ or $200,000 for single filers).

<u>**Alternative Minimum Tax (AMT) Exemption:**</u> The AMT exemption will drop back to approximately $85,000 for MFJ or $54,000 for single filers and perhaps more importantly, the exemption phase-out will drop back to approximately $161,000 for MFJ or $121,000 for single filers (currently the AMT exemption and phase-outs begin at about $127,000/$1,150,000 respectively for MJF or $81,000/$578,000 respectively for single filers).

<u>Estate Tax Exemption:</u> The unified lifetime credit will be cut in half (the current exemption amount is approximately $13 million per individual or $26 million per couple).

<u>Qualified Business Income (QBI) Deduction:</u> Owners of passthrough businesses, including partnerships, S corporations, and sole proprietorships, will no longer be allowed to deduct QBI under Section 199A (owners of passthrough businesses can currently deduct up to 20% of QBI).

<u>Corporate Tax Rate:</u> In addition to the individual tax changes, the TCJA also permanently changed the corporate tax rate from a bracketed structure with a top rate of 35% to a flat 21% tax rate. This is one of the few permanent provisions that does not expire at the end of 2025.

If the change to the corporate tax rate is permanent, why do the individual tax provisions of the TCJA expire? The answer has to do with how the law was passed. The TCJA was part of a reconciliation bill that is not subject to the Senate's filibuster rules that require a 60-vote supermajority rather than a standard majority. However, reconciliation bills are subject to certain limitations under what is known as the Byrd Rule (named after its principal sponsor, Senator Robert C. Byrd), which prevents the incorporation of extraneous matters into the bill. A provision is considered to be extraneous if it, among other things, would increase the deficit for fiscal years beyond those covered by the reconciliation measures which are typically 10 years. This budgetary limitation meant that not all the TCJA tax cuts could be permanent, and Congress chose to allow the individual tax provisions to expire at the end of 2025 in order to make the reduced 21% corporate tax rate permanent.

Candidates' Tax Plans

Following is an overview of the more significant tax policy proposals from each of the presidential candidates. Trump's proposals include making the TCJA's individual tax cuts permanent along with additional corporate tax cuts. Harris's proposals include raising taxes on individuals making over $400,000 and on corporations. Additional information on the candidates' tax plans can be found at taxfoundation.org.

<u>Individual Income:</u> One of the few tax policies the presidential candidates appear to agree on is exempting tips from taxable income. Trump has also proposed exempting Social Security benefits from taxable income. As indicated above, both candidates support extending many of the individual income tax provisions of the TCJA. However, Harris's plan would extend the tax benefits only to those making less than $400,000 while taxpayers with income over this amount would be subject to a 39.6% marginal tax rate. For these higher-

income taxpayers, Harris has also proposed increasing the additional Medicare tax on earned income from 0.9% to 2.1% and the net investment income tax (NIIT) from 3.8% to 5%. NIIT applies to capital gain, dividend, interest, rental, royalty, and other passive income, but Harris has indicated support for expanding this to also include active income from pass-through businesses. The additional tax revenue under Harris's plan would help to fund expanded individual tax credits including the child, earned income, and premium tax credits.

<u>Estate Tax:</u> Trump has proposed making the TCJA's increased estate tax exemption permanent. Harris has indicated that she would tighten the rules around the estate tax and seems in favor of allowing the estate tax exemption to drop to the pre-TCJA level which would essentially cut the current $13.6 million exemption in half.

<u>Capital Gains:</u> Regarding long-term capital gains, a Trump administration would presumably maintain the current rates of 0% for single filers with income up to approximately $45,000 ($90,000 for MFJ), 15% for single filers with income up to approximately $519,000 for single filers ($584,000 for MFJ), and 20% for individuals with income in excess of these amounts. Harris has proposed increasing the long-term capital gains rate to 28% for taxpayers with over $1 million of income and increasing NIIT from 3.8% to 5% as mentioned above. Harris also endorsed tax increases proposed by President Joe Biden in his 2025 budget, which included a tax on unrealized capital gains; however, there does not appear to be the necessary support in Congress for this to ever pass.

<u>Business and Corporate:</u> The candidates are in opposition with regard to the current 21% corporate tax rate put in place by the TCJA. Trump has proposed reducing the tax rate to 20% for all corporations and dropping the rate to 15% for corporations that make their products in the US. Trump has also proposed making permanent the few expiring business tax provisions of the TCJA, including 100% bonus depreciation and R&D expenses deductions, but would repeal the green energy tax credits put in place by the 2022 Inflation Reduction Act (IRA). Harris, on the other hand, has proposed increasing the corporate tax rate to 28%. Harris has also proposed increasing the corporate alternative minimum tax rate for corporations with over $1 billion of income, levying additional taxes on global corporations, and increasing the excise tax on stock buybacks.

<u>Excise Tax:</u> To offset tax cuts for individuals and corporations, Trump has proposed increasing the baseline tariff on all U.S. imports from 10% to 20% and imposing a 60% tariff on U.S. imports from China. During Trump's first term as president, his administration took a broad view of the president's authority with regard

to tariffs which makes this the only significant tax policy change that could arguably be implemented without Congressional approval. However, taxfoundation.org points out the negative economic consequences of the proposed tariffs which would need to be taken into consideration.

What Might Happen?

History provides an interesting perspective on the likelihood that a presidential candidate's tax proposals will actually pass into law. The following is a look at the more significant tax legislation that has passed during the last 30 years.

The TCJA was signed into law in 2017 by President Donald Trump after being passed by a Republican-controlled House and Senate. However, even with the republican party having control of both Congress and the Whitehouse, the TCJA was a scaled-back version of what Trump proposed as a candidate in 2016, which included reducing the top individual income tax rate to 33% and completely doing away with the estate and gift tax.

The most significant tax legislation passed since the TCJA was the Inflation Reduction Act of 2022 (IRA). The IRA was signed into law by President Joe Biden after being passed by a Democratic-controlled House and Senate. Again, despite the Democrats having control of both Congress and the Whitehouse, the IRA was nothing close to what Biden proposed as a candidate in 2020 which included repealing the TCJA for high-income taxpayers and increasing the corporate tax rate to 28%.

The Tax Relief for American Families and Workers Act of 2024 was the last significant piece of tax legislation passed by the House of Representatives. This act would have restored the TCJA's R&D expense and 100% bonus depreciation deductions and expanded the child tax credit. The act was passed by a republican controlled House of Representatives in January 2024 with strong bi-partisan support but was blocked in the Senate. Although the Senate was democrat controlled, the Senate's filibuster rules requiring a 60-vote supermajority prevented the law from being passed.

These recent examples highlight the challenges in passing tax legislation even if one party has control of both Congress and the Whitehouse. In fact, the Taxpayer Relief Act of 1997 is the only really significant piece of tax legislation that has been passed during the last 30 years when the president was not of the same party that controlled Congress. The Taxpayer Relief Act was signed into law by President Bill Clinton after being passed by a Republican-controlled Congress and established the Roth IRA and education tax credits, reduced the top long-term capital gains rate to 20%, and began increasing the estate tax exemption to $1 million.

Notably, the TCJA, IRA, Taxpayer Relief Act, and most of the other significant tax law changes over the last 30 years passed as a part of a reconciliation bill which, as previously discussed, is not subject to the Senate's filibuster rules requiring a 60-vote supermajority. However, reconciliation bills are subject to the Byrd Rule, which provides that these bills cannot increase the deficit for fiscal years beyond those covered by the reconciliation measures, which are typically limited to 10 years.

The only significant tax legislation during the last 30 years not passed as part of a reconciliation bill was the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 and American Taxpayer Relief Act of 2012, which were signed into law by President Barak Obama, after being passed by a democratically controlled Congress. However, these bills were, for the most part, not new tax laws but simply extended and ultimately made permanent the tax laws under the Economic Growth and Tax Relief Reconciliation Act of 2001 and Jobs and Growth Tax Relief Reconciliation Act of 2003. These tax laws are often referred to collectively as the Bush tax cuts and, among other things, reduced income tax rates for individuals and lowered the long-term capital gains rates.

The use of reconciliation bills to pass significant tax legislation is becoming increasingly commonplace and will likely result in more volatile tax policies in the future due to the limitations they place on Congress's ability to institute permanent tax changes. In reality, permanent tax laws are only permanent until Congress changes them, but if you are in favor of the current tax laws, then you would much prefer that Congress have to act in order to change them rather than have to act in order to keep them.

By extending and ultimately making the Bush tax cuts permanent, the Obama presidency provides a recent example of how it can be easier to keep existing law than to pass something new, even if the existing law was enacted by the other party. This, and the fact that both presidential candidates have expressed support for extending the TCJA for the majority of individual taxpayers, bodes well for the continuance of much of the TCJA. However, to prevent the TCJA from sunsetting at the end of 2025, Congress must come to an agreement which is something Congress often struggles to do.

What may happen with the TCJA is far from clear and equally unclear is the timing of any legislation that could extend it. However, recent history provides some insight into possible timing. All the tax legislation mentioned above either passed before Congress took its traditional August recess or did not pass until the very end of the year (or the beginning of the following year). This provides some precedence that if an extension of the TCJA is not in place by August, we may not have certainty until the end of 2025 or even early 2026.

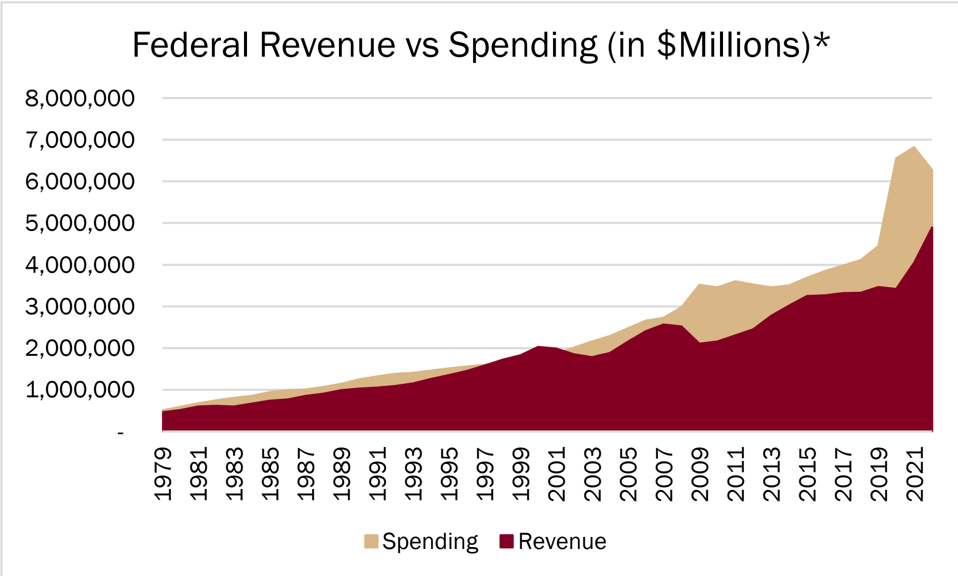
Historically, a number of tax laws have been retroactive back to the date the relevant Bill was introduced, or to the first day of the calendar year in which the legislation passed. The American Taxpayer Relief Act of 2012 provides a recent example, although it was retroactive only one day. There are practical and legal limits as to how far back a tax law could extend, but if there is an extension of the TCJA it is possible that it may not be passed until 2026. Because of this, taxpayers may have little or no time to implement, let alone plan, tax strategies around the sunset or possible extension of the TCJA.

Strategies to Consider

The TCJA made significant tax law changes that included lowering tax rates, increasing the standard deduction, adding a new 20% deduction for passthrough qualified business income, increasing the AMT exemption and phase-out threshold, and doubling the estate tax exemption. As previously noted, these and nearly all of the other individual tax provisions of the TCJA are scheduled to sunset at the end of 2025 unless Congress acts to extend them. Assuming legislation to extend or replace the TCJA is not passed until late 2025, taxpayers will need to have a strategy in place that can be implemented quickly, which will require advanced planning.

Below are some tax planning strategies to consider in advance of the sunset or possible extension of the TCJA, but before going into these it's worth pointing out that all tax strategies are predicated on the knowledge or belief that future tax rates will be higher (or lower) than today. Although the candidate's plans have little in common, they both share at least one likely outcome which is an increased Federal deficit. The Congressional Budget Office estimates that extending the individual Income tax provisions of the TCJA would increase the deficit by nearly $3.3 trillion over the next 10 years. Although Harris has proposed extending the TCJA only to individuals making less than $400,000, any additional tax revenue under Harris's plan would likely be offset by her proposed increases to the individual tax credits.

Since the 1960's the U.S. has run a deficit in all but four years (1998 – 2001). The chart below shows how much Federal spending has exceeded revenue over the past few decades. Revenue has gone up, but spending has outpaced it by an increasingly large margin. According to fiscaldata.treasury.gov, the amount the U.S. pays on interest currently accounts for 13% of national spending which is more than is spent on national defense. The increased interest expense will make it difficult to achieve a balanced budget with spending cuts alone. Increased revenue will likely also be required, which could mean increased tax rates in the future. Individual tax rates are not certain to go up, the corporate income tax is at a historically low rate not seen since the 1930s and could be targeted before an increase in the individual tax rates. However, individual income tax currently accounts for nearly half of all U.S. revenue, and the deficit is likely to be a factor with regard to future tax rates across all revenue sources.



* Information from [Monthly Treasury Statement]

<u>Use Estate Tax Exemption</u>: The lifetime estate and gift tax exemption, which is indexed for inflation, is $13.61 million per individual in 2024 but will be essentially cut in half in 2026 unless the TCJA is extended. Families with estates in excess of the anticipated 2026 exemption amount (approximately $7 million per individual or $14 million per married couple) should consider strategies to take advantage of the current increased exemption. The challenge is that the only way to take full advantage of the current exemption is to use all of it before the TCJA sunsets at the end of 2025. Any of the increased exemption amounts that are not used will be lost. An individual's lifetime exemption is reduced by the amount the individual gives away during life, so an individual that gives away any amount in excess of approximately $7 million will have no exemption remaining in 2026 even though they could have given away up to around $14 million tax-free if they had done so before the TCJA sunset.

There are strategies to take advantage of the increased exemption. One of the most common strategies for married couples is having one spouse gift assets to an irrevocable trust for the benefit of the other spouse in such a way as to remove the assets from the couple's taxable estate while still allowing the beneficiary spouse to access the assets if needed. This type of trust is known as a Spousal Lifetime Access Trust (SLAT). There are, however, a number of tax and non-tax considerations, not the least of which is the possibility of divorce. In addition, many planning strategies, such as SLATs, may need to be implemented over the course of more than one tax year to minimize the risk of being challenged by the IRS. Because of this, families that anticipate having a taxable estate should speak with their financial advisor or estate planning attorney about planning options that could minimize the potential estate tax liability as soon as possible.

Exercise Incentive Stock Options (ISOs): This planning strategy applies to individuals with ISOs. With the TCJA sunset, the AMT exemption amount and phaseout threshold will be reduced significantly, exposing more individuals to AMT. As a reminder, AMT is a parallel tax calculated at a flat rate of 26% or 28% based on AMT taxable income, which is a taxpayer's AGI plus certain preferential tax items that are not included for purposes of the regular tax calculation. The AMT calculation is compared to the regular tax calculation and a taxpayer pays the higher of the two. Individuals can exercise ISOs and defer paying the tax until the stock is eventually sold. However, for purposes of the AMT calculation, income from exercising these options is included in AMT taxable income in the year the options are exercised. Individuals with ISOs should speak with their financial advisor or CPA about exercising some or all of the options by the end of 2025, which could allow them to avoid AMT and defer tax until the stock is sold.

Accelerate QBI: This planning strategy applies to owners of passthrough businesses, including partnerships, S corporations, and sole proprietorships. The biggest question for most individuals is whether their income tax rate will be higher in 2026 than it is today in order to determine whether they should attempt to accelerate and recognize income before the end of 2025. This is particularly important for business owners who may be able to control when income is received. The TCJA allows owners of passthrough businesses to deduct up to 20% of their QBI, but this provision is scheduled to sunset at the end of 2025. Passthrough business owners may benefit from accelerating income and recognizing it in 2025 while the 20% QBI deduction is still in effect. Note however that the 20% QBI deduction for owners of Specified Service Trades or Businesses (SSTB), such as law firms, begins to phase out when taxable income reaches certain levels ($383,900 for MFJ and $191,950 for single filers in 2024), and it may not be beneficial for owners of SSTBs to accelerate income in excess of the phase-out limits.

<u>Bunch Deductions</u>: Taxpayers who make charitable gifts cannot take advantage of the tax benefit associated with the gifts unless they itemize deductions. Because of the current higher standard deduction ($29,200 for MJF and $14,600 for single filers in 2024) and the $10,000 cap on the itemized deduction for state and local taxes (SALT), fewer taxpayers currently itemize. However, taxpayers who make charitable contributions that would bring their total itemized deductions close to the standard deduction should consider making their 2025 charitable gifts in 2024. By bunching two years' worth of charitable gifts into 2024, a taxpayer's itemized deductions could exceed the standard deduction. The taxpayer could then take the standard deduction in 2025 just as they would have otherwise done. Taxpayers who plan to make a significant charitable gift in the near future should also consider deferring the gift to 2026. The tax benefit of a deduction increases as tax rates increase, so deferring a charitable gift until after the TCJA sunset could be more beneficial from a tax perspective. Similarly, the cap on the SALT deduction is scheduled to go away with the expiration of the TCJA, so to the extent allowed, taxpayers might consider deferring payment of their 2025 property taxes to 2026 so they can fully deduct the tax in 2026 when they may also be subject to a higher tax rate.

<u>Retirement Distributions and Conversions</u>: Following the sunset of the TCJA, the individual income tax will revert to the pre-TCJA rates and brackets with the top marginal rate going from 37% to 39.6%. Most taxpayers would see an increase in their marginal tax rate under the per-TCJA structure, and for some taxpayers, the increases would be significant. For example, the marginal rate for married couples filing jointly who have approximately $300,000–$400,000 of taxable income would go from the current 24% to 33% following the TCJA sunset even with the same level of income. Taxpayers facing an increase in their marginal tax rate (especially a 9% increase) should consider accelerating income to take advantage of the current lower tax rates by taking additional distributions from their traditional IRA or 401(k) in 2024 and 2025. This strategy could have an even greater impact on owners of traditional IRAs that were inherited in 2020 or later since, in most cases, these accounts must be fully distributed within 10 years.

A Roth IRA conversion is another option for accelerating income. As a reminder, Roth IRAs are funded with after-tax dollars, so converting a traditional IRA to a Roth IRA requires the owner to pay tax similar to if the conversion had been a distribution, but the amount converted can then grow tax-free and can be withdrawn tax and penalty-free after age 59½ as long as the account has been open for at least five years. The advisability of a Roth conversion centers around the difference between current and future tax rates. While the income tax strategies mentioned above primarily involved shifting income or deductions between adjacent tax years, a Roth conversion may result in recognizing income that could have otherwise been deferred for a number of years. This makes it impossible to knowledgeably plan around Roth conversions based on future tax rates alone. However, taxpayers may be able to effectively plan based on their specific circumstances. For example, a taxpayer who built up a large tax-deferred account and was in a high tax bracket while working could temporarily find themselves in a much lower tax bracket following retirement but before having to start taking required minimum distributions (RMDs). In cases such as this, it would make sense to take distributions or make Roth conversions to fill the lower tax brackets.

Conclusion

The tax strategies listed above offer some planning opportunities to consider in advance of the sunset or possible extension of the TCJA, but there are additional considerations and, as mentioned above, some taxpayers would likely even benefit from the expiration of the TCJA. Because of this, individuals need to speak with their financial advisor about the planning strategies that best fit their situation. Ultimately, it is impossible to predict what U.S. tax law will be in 2026 and beyond, but there are still planning opportunities. The key is to have a strategy in place that can be implemented quickly once we do have clarity. This will require advanced planning which makes it important for individuals to speak with their financial advisor about planning opportunities sooner rather than later.

If you have any questions or would like to discuss further, please reach out to your client service team, or call 404.264.1400. You can also visit us on the web at HomrichBerg.com.

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