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Preparing for 2025: Understanding Upcoming Tax Changes

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Agenda

- TCJA and Tax Reform Overview
- Key TCJA Expiring Provisions
- Impact of Process and Political Landscape on 2025 Tax Legislation
- Costs of Extending the TCJA and Potential Revenue Raisers

Introduction

- When the Tax Cuts and Jobs Act (TCJA) was enacted in 2017, several of the provisions were set to sunset in 2025 (or before).
- These expiring provisions will impact both individual taxpayers and businesses.
- As a result, Congress is likely to consider significant tax legislation next year.
- The scope of any potential tax legislation in 2025 will depend on the outcome of the 2024 Presidential election, which party controls the House and Senate after the election, and the process used to enact any legislation.
- The cost of extending tax provisions will also be a focus of policymakers and Congress may attempt to modify or eliminate certain tax exclusions, deductions, or credits to raise revenue.

TCJA Expiration and 2025 Tax Reform Overview

- TCJA was the first significant rewrite of the tax code since 1986 and made several changes to both individual, estate, and corporate tax provisions but was passed on a purely partisan basis.
- Legislation (H.R. 7024) to extend several expiring TCJA business provisions and the Child Tax Credit sailed through the House with 350 votes but has stalled in the Senate.
- The non-partisan Congressional Budget Office (CBO) recently found that extending the TCJA's provisions would cost more than $4 trillion over 10 years.
- Everything will be on the table for reform in 2025.
    - Tax Writing Committees in the House and Senate already preparing for tax legislation in 2025.
- With this potential legislation on the horizon, stakeholders are now beginning to develop their policy priorities for consideration next year.

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Key TCJA Provisions

KEY EXPIRING PROVISIONS

Provision	Current Law Under TCJA	Law in 2026 if Congress Doesn't Act
Marginal Tax Rates	Marginal rates are currently: 10%, 12%, 24%, 32%, 35%, and 37%. > $731,200: 37%	Marginal rates will revert to their pre-TCJA levels of 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%.
Standard Deduction	The TJCA almost doubled the standard deduction and adjusted the amounts for inflation. For 2024, the basic standard deduction amounts are $14,600 for single filers, $21,900 for head of household filers, and $29,200 for married taxpayers filing jointly	The basic standard deduction amounts will revert to their pre-TCJA levels and then be adjusted for inflation. For 2018, prior to the TCJA, the basic standard deduction amounts for 2018 would have been $6,500 for single filers, $9,550 for head of household filers, and $13,000 for married taxpayers filing jointly.

KEY EXPIRING PROVISIONS

Provision	Current Law Under TCJA	Law in 2026 if Congress Doesn't Act
Alternative Minimum Tax	A tax is imposed at 26% on an individual's alternative minimum taxable income, with a higher rate of 28% applied to taxpayers with alternative minimum taxable incomes above $232,600 in 2024. For 2024 the AMT exemption amounts are $85,700 for singles/heads of households and $133,300 for married couples. The AMT exemption amount phases down when a taxpayer's income exceeds a phaseout level. These levels are $578,150 for single and head of household filers and $1,156,300 for married taxpayers filing jointly.	The AMT exemption and exemption phaseout will revert to pre-TCJA levels and then both will be adjusted for inflation. For 2018, prior to the TCJA, the higher 28% rate applied to incomes above $191,500 for married couples. For 2018, prior to the TCJA, the exemption amounts were $55,400 for singles and head of households filers and $86,200 for married couples filing jointly and the exemption phaseouts were $123,100 for single and head of household filers and $164,100 for married couples filing jointly in 2018
Child Tax Credit	The TCJA increased the maximum value of the Child Tax Credit to $2,000 per qualifying child, expanded the phase-in and phase-out, and capped refundability	The Child Tax Credit will revert to its pre-TCJA structure and provide up to $1,000 per qualifying child with an increased phase-in and reduced phase-out threshold.

KEY EXPIRING PROVISIONS

Provision	Current Law Under TCJA	Law in 2026 if Congress Doesn't Act
Section 199A Deduction for Pass-Through Income	Section 199A allows sole proprietors, S corporations, and partnerships to deduct up to 20% of qualified business income earned in a qualified trade or business to align the tax rates for pass-throughs with the reduced rate for C-corporations.	The Section 199A deduction will expire and passthrough business income will generally be taxed according to ordinary individual income tax rates (39.6% in 2026) without a deduction for qualified business income. ***Note*: TCJA made permanent the 21% rate for C-corporations.**
Estate Tax Exemption	The TCJA increased the estate tax exclusion to $10 million per decedent and adjusted annually for inflation. For 2024, the exclusion is $13.61 million for individuals and $27.22 million for married couples.	The estate tax exclusion will be reduced to $5 million per decedent and adjusted annually for inflation.
State and Local (SALT) Tax Deduction	The TCJA reduced the state and local tax deduction to only allow taxpayers to deduct up to $10,000 in state and local taxes.	The $10,000 state and local tax deduction cap will expire.

KEY EXPIRING PROVISIONS

Provision	Current Law Under TCJA	Law in 2026 if Congress Doesn't Act
ABLE Account Contribution Limits	Under the TCJA, a designated beneficiary who is employed can contribute an additional amount to their ABLE account (above the annual gift-tax exclusion amount), subject to certain limitations.	While the gift tax exclusion will still apply, designated beneficiaries will not be able to make additional contributions.
ABLE Accounts and the Saver's Credit	Designated beneficiaries who make qualified contributions to their ABLE account can qualify for a nonrefundable saver's credit of up to $1,000.	Designated beneficiaries will not be able to claim the saver's credit for their contributions.
529 to ABLE Account Rollover	Rollovers from a 529 account to an ABLE account that are less than or equal to the annual ABLE contribution limit are not subject to taxation, provided that the accounts have the same designated beneficiary (or the designated beneficiaries of the two accounts are members of the same family). The portion of the rollover (plus any other contributions to the account) in excess of the annual contribution limit is taxable.	All rollovers from 529 accounts to ABLE accounts will be subject to taxation.

TCJA Overview: Business Provisions

- The TCJA also made significant changes for corporate taxpayers, including making some provisions permanent.

Corporate Tax Rate

- Permanently reduced the tax rate from 35% to 21% for C corporations.

Net Operating Losses:

- Limited NOL deduction to 80% of taxable income and unused losses cannot be carried back. NOLs can only be carried forward.

Section 168(k) Bonus Depreciation

- Provided 100% bonus depreciation through 2022 before phasing down through the end of 2026.

TCJA Overview: Business Provisions

Section 163(j) Business Interest Deduction

- Limited the amount of net interest a business could deduct to 30% of adjusted taxable income.
  - Before 2022: 30% of EBITDA; 2022 and after: 30% of EBIT

Section 174 Research and & Development

- Allowed companies to fully expense R&D costs until 2022 when companies have to amortize the costs over 5 years.

Opportunity Zones

- Created qualified Opportunity Zone tax incentive program to provide several tax benefits for investing in certain economically distressed areas.

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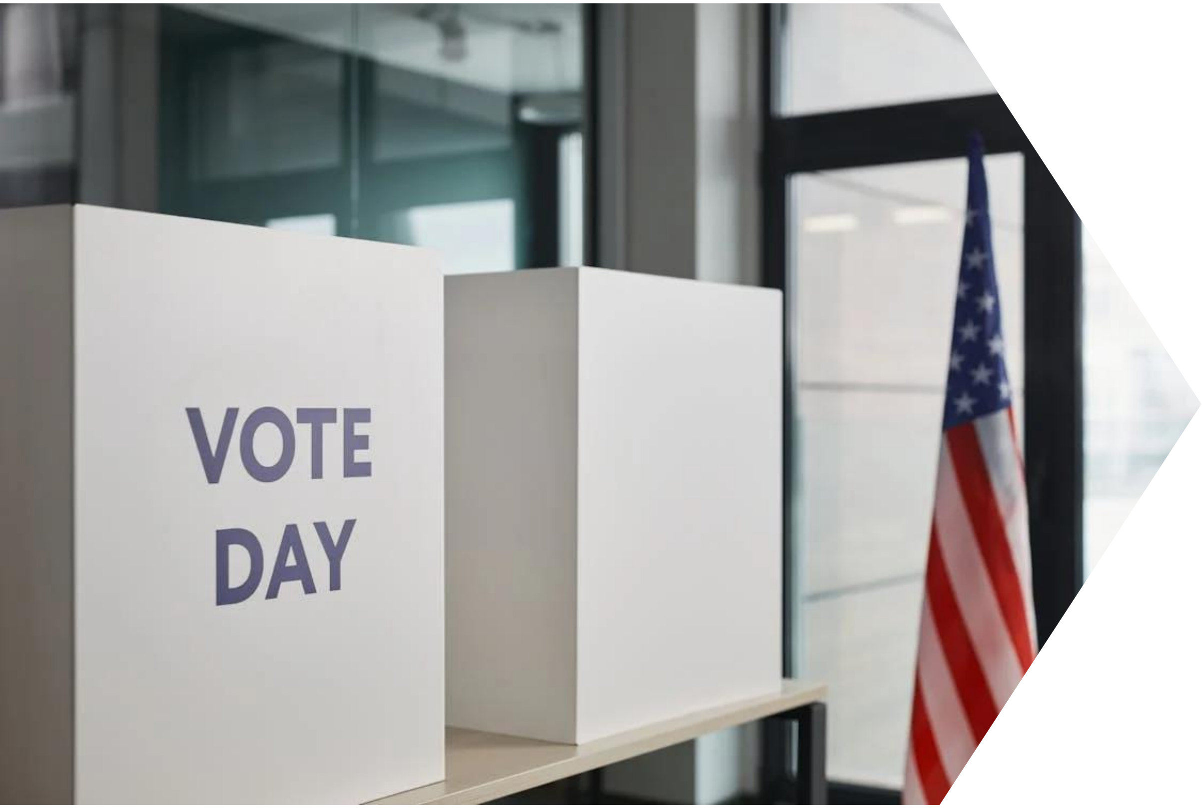
Impact of Process and Political Landscape on 2025 Tax Legislation

Tax Legislation Under Different Political Scenarios



- The outcome of the 2024 elections will determine the process, politics, and policies related to addressing the TCJA's expiring provisions in 2025.
  - The Process: Will one party control Congress and the Presidency and use the budget reconciliation process?
  - The Politics: Will politics cause Congress to kick the can down the road? Will tax legislation address the debt? How will Republicans handle budgetary concerns versus President Trump's urging to extend the TCJA and further cut taxes?
  - The Policies: What policies will the Republicans and Democrats prioritize and where are the opportunities for compromise?

Process: Budget Reconciliation

- Highly partisan process that will depend on the outcome of the 2024 elections
- Generally only-used under complete one-party control
  - Republicans: TCJA (2017)
  - Democrats: Inflation Reduction Act (2022), Affordable Care Act (2010)
- Congress must first pass a budget resolution to set the spending limits
- Benefits:
  - Only 50-votes are required in the Senate to pass budget reconciliation legislation.
- Limitations:
  - Policies must fit into the specific revenue limits and can lead to temporary tax policies.
    - In 2017, the TCJA’s $1.5 trillion limitation caused certain provisions to sunset in 2025.
  - Under the Budget Control Act’s “Byrd Rule,” Senators can block provisions of reconciliation bills that do not impact spending or revenues or where the change in spending is merely incidental.

Politics: Congressional Action or Inaction?

- Tax reform will be a significant undertaking and Congressional politics could delay the consideration of any TCJA-extension legislation into 2026.
- Unified one-party control and reconciliation could ease the process.
  - Even under unified Republican control in 2017 and using budget reconciliation, Congress did not pass the TCJA until December 2017.
- Congress usually acts at the last minute and will often delay consideration of significant legislative packages.
  - In 2010, Congress passed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 to temporarily extend the Bush Tax Cuts for another two years.
  - Congress did not act again until New Year's Eve in 2012 to address the "fiscal cliff" in the American Taxpayer Relief Act of 2012.

Politics: Cost of Extension

Due to increasing budget deficits and national debt, the cost of extending the TCJA's tax provisions is a major focus of policymakers. CBO recently estimated the cost of extending the TCJA's tax provisions would increase deficits by $4 trillion over the next 10 years.

Current National Debt: $35 Trillion

FY23 Budget Deficit: $1.7 Trillion

Politics: Cost of TCJA Extension

House and Senate Republicans will likely debate whether an extension of the TCJA should be offset with additional new revenue.

Some Republican Senators have claimed that pro-growth tax cuts or an extension of current law should not be offset:

- "We need to look more closely at what we're referring to because some people call these economy-growing tax cuts, which I agree would not need to be paid for." - Sen. John Cornyn (R-TX).
- "Our policy has been — I can't really speak for the House — if you're extending existing tax policy, that isn't offset…And secondly, if it's a pro-growth tax policy, it's going to generate more revenue." - Sen. John Thune (R-SD).

Key House Ways and Means Republicans disagree:

- **"I don't think anyone on our side is interested in growing the deficit." - Rep. Lloyd Smucker (R-PA).**
- **"We're $35 trillion in debt. We're adding a trillion dollars every 100 days. We have to have pay-fors. It's just not sustainable." - Rep. Beth Van Duyne (R-TX).**
- **"We're going into a big tax year next year, and this is going to be front and center. I think that we should pay for as much as we can — the goal being growth, not just slashing or reducing rates. For me that's always been about finding a point of equilibrium." - Rep. Brian Fitzpatrick (R-PA).**

Impact of the Political Landscape: Democrats Control Congress & the Presidency

- Modify Individual Tax Rates
  - Extend the TCJA's reduced individual tax rates for income less than $400,000
  - Return top individual tax rate to 39.6% for income more than $400,000
- Extend and enhance the Child Tax Credit
  - The top Democratic tax policy priority in the Tax Relief for American Families and Workers Act (H.R. 7024) that passed the House in January.
  - Vice President Harris has called for tripling the Child Tax Credit to $6,000
- Advocate for new or enhanced credits to help low-income taxpayers address consumer costs for health-care, child care, and housing
  - Extend the ACA's health-care premium tax credits
  - Vice President Harris has called for new incentives to help first-time home buyers with up to $25,000 in down payment assistance/tax credits.

Impact of the Political Landscape: Democrats Control Congress & the Presidency

- To offset the cost of these tax credits, Democrats will likely seek to raise taxes on corporations and high-net worth taxpayers.
  - Starting point would likely be the tax provisions in the Build Back Better (BBB) Act that were not included in the IRA and the tax provisions included in President Biden's FY 2025 Budget.
  - Democrats will likely focus on increasing taxes on high-net worth taxpayers, including unrealized gains or the net-investment income tax.
    - Proposed by both President Biden and Senate Finance Committee Chairman Wyden, but these proposals do have not unanimous support among Democrats.
- Democrats will also likely seek to increase the TCJA's reduced 21% corporate tax rate.
  - Democrats have generally coalesced around Vice President Harris' 28% proposal.

Impact of the Political Landscape: Republicans Control Congress & the Presidency

- Extend the TCJA's reduced marginal individual tax rates and increased standard deductions for all taxpayers.
- Extend the TCJA's section 199A deduction to align the tax rate for pass-throughs with the 21% corporate tax rate.
  - CBO estimates a combined extension of both these policies would cost $2.8 trillion.
- Extend other TJCA business-related expired or expiring provisions:
  - Section 168(k) Expensing:
    - TCJA temporarily allowed full expensing (100% bonus depreciation) in the first year through 2022 before phasing down through 2026.
  - Section 163(j) Interest Deduction:
    - Expanded definition of adjusted taxable income that expired in 2022.
  - Section 174 Research and Development:
    - Starting in 2022, the TCJA requires companies to amortize their R&D costs over five years, instead of deducting them immediately each year.

Impact of the Political Landscape: Republicans Control Congress & the Presidency

- On the campaign trail, President Trump has proposed new tax and revenue policies:
  - Exclude Tipped Wages from Federal Taxable Income
    - Under current law, workers must report tipped wages as taxable income.
    - President Trump has proposed to exclude all tipped wages from federal taxable income.
      - It is unclear if President Trump's plan would exclude tipped wages from federal income tax, from payroll taxes, or both.
      - Vice President Harris also announced her support for excluding tipped wages from taxable income.
  - Eliminate Taxes on Overtime Pay
    - President Trump has called for excluding income from overtime wages from federal taxable income.
      - It is unclear if President Trump's plan would exclude overtime wages from payroll taxes.
  - Eliminate Taxes on Social Security Benefits
    - Under section 86, up to 85% of a taxpayer's Social Security benefits can be taxed at ordinary rates based on the taxpayer's income level.
    - President Trump has proposed to end these taxes on Social Security benefits.
  - Increase Tariffs
    - President Trump has called for imposing a 10% tariff on most products imported into the U.S. and a 60% tariff on Chinese goods. President Trump has proposed using the tariff revenue to offset extending the TCJA.

Impact of the Political Landscape: Republicans and the Corporate Tax Rate

- In 2017, the push to enact the TCJA was largely driven by a desire to reduce the corporate tax rate.
  - Republicans and U.S. corporations were in agreement that the U.S. statutory corporate tax rate was too high and anti-competitive.
- Republicans will likely face pressure to maximize tax policy favorable for businesses to spur growth and investment but certain factions of the Republican Party in Congress have developed a more populist approach to reducing taxes on the middle class.
  - Ways and Means Chairman Jason Smith (R-MO) has stated the TCJA would not pass through today's Republican-led House of Representatives.
- Heading in 2025, Republicans are not in lock-step and increasing the corporate income tax rate could be a potential revenue raiser to offset extending the TCJA's individual rates.

Impact of the Political Landscape: Potential Compromises in Divided Government

- Extend TCJA's Reduced Marginal Rates for Income of less than $400,000
  - Both Vice President Harris and President Trump support extending these TCJA-level marginal tax rates.
- Increase Marginal Rates for Income of more than $400,000
  - A compromise agreement to lock in the TCJA's reduced marginal tax rates could be paired with an agreement to increase marginal tax rates for income above $400,000 to raise additional revenue.
  - In early 2013, when Republicans controlled the House and Democrats controlled the Senate, an agreement was reached to permanently extend the Bush-era tax rates for all individuals with income of less than $400,000 and joint filers with incomes below $450,000.
- Increase Corporate Tax Rate
  - Congressional Republican's increased economic populism has drawn additional support for increasing the corporate tax rate and Congressional Democrats are in unison with increasing the corporate tax rate.
  - A compromise agreement to raise the corporate tax rate could offset some of the cost of extending the TCJA's reduced individual marginal tax rates.

Impact of the Political Landscape: Potential Compromises in Divided Government

- Compromise Extension of Section 199A
  - The Section 199A deduction is set to phase out in 2026. Section 199A already includes several trade and business limitations and income limitations. Some Democrats have criticized the Section 199A deduction as a giveaway to high-net worth taxpayers, raised concerns about potential abuse, and criticized its effectiveness.
  - Compromise legislation to extend the provision could include further income limitations or restrictions.
- Extension of Child Tax Credit Paired with Extension of Certain Corporate Provisions
  - The TCJA doubled the Child Tax Credit and Democrats increased the Child Tax Credit in the American Rescue Plan to up to $3,600. The Child Tax Credit is set to return to its pre-TCJA level of $1,000 in 2026.
  - The Tax Relief for American Families and Workers Act (H.R. 7024) could serve as a model for next year for pairing an extension of corporate provisions with an extension of tax provisions benefitting families.
    - This compromise legislation included an extension of an increased Child Tax Credit along with extensions of several of the TCJA's expired or expiring business provisions, including an extension of the TCJA's research and development tax incentives, extension of the TCJA's enhanced interest deduction, and an extension of bonus depreciation.

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Costs of Extending the TCJA and Potential Revenue Raisers

Cost of Extending the TCJA

- The non-partisan CBO recently found that extending the TCJA's provisions would cost more than $4 trillion over 10 years.
- CBO also found that extending the expanded ACA premium health tax credits will cost an additional $383 billion over the same period.
- The "cost" of extending the TCJA and ACA's tax provisions will drive the politics and decision-making around what policies are prioritized for any 2025 tax legislation.
- The most significant cost driver of extending the TCJA is the reduced marginal individual tax rates and the increased standard deduction.
  - Both Vice President Harris and President Trump have pledged to extend the TCJA's reduced marginal rates for taxable income of $400,000 a year or less.

Cost Concerns and Revenue Raisers

- When Congress begins to consider large-scale tax reform, members of Congress look for other changes to the tax code that would raise revenue to offset tax cuts in other areas.
- There will likely be pressure on members of Congress to modify some existing tax provisions to raise additional revenue to offset the additional cost of extending the TCJA.
  - Democrats will focus on President Biden's Greenbook Proposals and the House-passed Build Back Better Act.
  - Republicans will likely target repealing certain provisions of the Inflation Reduction Act.
- Limited opportunities for bipartisan revenue raisers.
- Current tax preferences for insurance and other investments could be a target.

10 Year Cost of Extending Key Expiring Tax Provisions

Provision	10-Year Cost Estimate
Reduced Marginal Tax Rates	$2.15 Trillion
Limit on Itemized Deductions (including $10K Salt Deduction Limit)	[$1.86 Trillion]
Alternative Minimum Tax (AMT) Exemption and Phaseouts	$1.35 Trillion
Increased Standard Deduction	$1.25 Trillion
Increased Child Tax Credit	$747.7 Billion
Section 199A Deduction	$684.2 Billion
Expansion of ACA Premium Tax Credits	$383 Billion
Section 168(k) Expensing	$378.5 Billion

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See Congressional Budget Office, Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues (May 2024), https://www.cbo.gov/system/files/2024-05/60114-Budgetary-Outcomes.pdf.

10 Year Cost of Key Tax Expenditures

Provision	10-Year Cost
Employer Sponsored Insurance Exclusion	$3.4 Trillion
Exclusion of Contributions to Pensions/IRA/401K	$3.1 Trillion
Preferential Capital Gains Rate	$1.5 Trillion
Tax Free Inside Build-Up of Life Insurance Products	$187 Billion
Exclusion of Employer Provided Life Insurance Benefits	$44.9 Billion

See Department of the Treasury, Tax Expenditures in Fiscal Year 2025, (Mar. 11. 2024), https://home.treasury.gov/system/files/131/Tax-Expenditures-FY2025.pdf.

"Rothification" of 401K or IRA Plans

- Current Law: A traditional 401(k) or IRA is funded with pre-tax income and is taxed upon withdrawal. A Roth IRA is funded with after-tax income and may be withdrawn tax free.

- Proposal: Concrete plans for Rothification have not been introduced but could be considered as a revenue raising measure.

  - Rothification is the conversion of some or all traditional defined contribution plans to Roth-like plans. Proposals vary but generally, Rothification would eliminate the pre-tax deductions and deferrals for retirement savings and instead allow after-tax contributions only.
    - Rothification was considered in 2017 to offset the cost of the TJCA but was not included.
    - Rothification was used in certain provisions of the SECURE Act 2.0 in 2022, such as for catch-up contributions for participants over age 50 must be to a Roth account.

- Impact of Rothification

  - Policymakers consider Rothification because it immediately generates large amounts of short-term tax revenue that can offset the cost of other tax expenditures.

  - Rothification mainly alters the timing of collecting tax revenue to allow it to be collected within the 10-year budget window that Congress considers when estimating cost impacts.

Increasing Individual Tax Rates

- Current Law: The TCJA lowered the top marginal individual income tax rate to 37% for taxable income over $731,200 for married individuals filing jointly.
  - Without Congress extending the TCJA, the marginal tax rate in 2026 and after will be 39.6%.
- Vice President Harris Proposal:
  - 39.6% top marginal tax rate for taxable income over $400,000 for married individuals filing jointly.
  - Extend the TCJA's reduced individual rates for income less than $400,000.
- Build Back Better Act:
  - Not addressed (an earlier version of the BBB Act proposed a top rate of 39.6%).

Raising Capital Gains and Dividends Rates

- Current Law: Long-term capital gains and qualified dividends are taxed at 20%. The TCJA did not modify or amend these rates.
- Vice President Harris Proposal:
  - Long-term capital gains and qualified dividends of taxpayers with taxable income over $1 million would be taxed at 28%
    - Lower rate than called for under the Biden Administration's FY25 Budget
- Build Back Better Act Proposal:
  - Not included (an earlier version of the BBB Act would have increased the rate to 25% for transactions occurring after September 2021).

Increasing the Estate Tax

- Current Law: The TCJA increased the estate tax exclusion to $10 million per decedent and adjusted annually for inflation. Estates with assets above the exclusion amount are taxed at 40%. In 2026, the estate tax exclusion will be reduced to $5 million per decedent and adjusted annually for inflation.
  - For 2024, the exclusion is $13.61 million for individuals and $27.22 million for married couples.
- Vice President Harris Proposal:
  - Lower the estate tax exemption to $3.5 million per decedent and impose an increased estate tax
    - $3.5 Million - $13 Million: 55%
    - $13 Million - $93 Million: 60%
    - > $93 Million: 65%
    - > $1 Billion: Additional 10% surtax

Increasing Net Investment Income Tax

- Current Law: Individuals with modified adjusted gross incomes over a threshold amount are subject to a 3.8% tax on net investment income.
  - The threshold is $200,000 for single and head of household returns, $250,000 for joint returns, and $15,200 (for 2024) for estates and trusts.
- Biden Administration Proposal: Increase to 5% for taxpayers with taxable income over $400,000 if married filing jointly. The threshold would be indexed for inflation.
- Build Back Better Act Proposal: Applies the 3.8% tax on net investment income to all trade or business income (i.e., S corporations and partnerships) for taxpayers earning $400,000 ($500,000 if married filing jointly).

Taxing Unrealized or Built-In Gains

- Current Law: Capital gains are generally taxable only upon a realization event, such as the sale or other disposition of an appreciated asset. As a result, the federal income taxation of asset appreciation that accrues during the asset's holding period is deferred.
  - In the case of unrealized appreciation at death, the basis adjustment (usually, a step-up) for a decedent's assets may cause federal income taxation of that gain to be eliminated entirely.
- Vice President Harris Proposal:
  - Impose a new 25% minimum tax on total income, including unrealized capital gains, for all taxpayers with net wealth of greater than $100 million.
    - Any potential wealth tax or tax on unrealized gains is likely to raise constitutional concerns, particularly considering the Supreme Court's recent decision in *Moore v. United States.*
  - Payments of the minimum tax would be treated as a prepayment available to be credited against subsequent taxes on realized capital gains to avoid taxing the same amount of gain more than once.

Repeal the Inflation Reduction Act's Energy Tax Incentives

- Current Law: The IRA, without Republican support, enacted long-term extensions of several clean energy tax credits, some for up to 10-years and others for potentially even longer.
- Republican's Proposal: House and Senate Republicans have targeted repeal of the IRA's clean energy tax credits and using the savings to extend the TCJA's expiring provisions.
- Revenue Raised: Republicans have urged repeal of the IRA's clean energy credits due to their increasing costs.
  - JCT Initial Score of IRA's Clean Energy Credits in 2022: $200 billion
  - JCT Score of Repeal of the IRA's Clean Energy Credits in 2023: $515 billion

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