Lowenstein Sandler's Trusts & Estates Podcast:
Splitting Heirs

Episode 22:
The One Big Beautiful Bill: It’s Big, But How Beautiful Is It?

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Warren Racusin: All hail, the One Big Beautiful Bill. President Trump's signature legislation was signed into law on July 4th, 2025. What a coincidence. And most, if not all of it takes effect on January 1, 2026. So, it's high time we talk about what OB3, that's what the cool kids call it, or the tax geeks, depending upon your point of view. It's high time we talk about what OB3 does and how you plan for it. And as we'll see, surprise, surprise, there are some things in OB3 that aren't quite as beautiful as the name might suggest. From the law firm, Lowenstein Sandler, this is Splitting Heirs. I'm Warren Racusin. And do we ever have a couple of cool kids to take us through it? My colleagues, Beth Kaufman and Kristin Taylor. Beth is the national chair of Lowenstein's Private Client Services Group. In a former life, she was the associate tax legislative counsel in the United States Department of Treasury.
And most importantly, she is a Splitting Heirs veteran. Kristin, our Splitting Heirs rookie of the year, is a partner in our tax group and works closely with our T&E folks at the intersection where savings and estate planning meet. Beth, Kristin, welcome.

Kristin Taylor: Thanks, Warren.

Warren Racusin: First, let's talk a little bit about the fact that OB3 makes permanent changes in the tax law. Beth and Kristin, how permanent is permanent?

Kristin Taylor: I'd have to say as with most things tax, it depends. As we'll see when we get into it a little bit later, some of the beautiful benefits put forth by OB3 are intended to sunset. Coincidentally, just as the current administration will be also sunsetting, while others purport to be permanent, but permanency is always dependent on the whims of Congress.

Beth Kaufman: Whenever I say permanent, I put air quotes around it because permanent is only permanent until Congress decides that it isn't.

Warren Racusin: So, there are things that are permanent in air quotes. There are things that are not so permanent, and they'll find out as time goes by, but they're permanent for now at least. So, let's dive in a little bit. Beth, let's start with you and estate taxes, that 40 percent bite that Uncle Sam can take from your estate when you pass away. There is a big exemption to that estate tax, a get out of jail free card, but we've all been very concerned that big estate tax exemption carriage was going to turn back into a smaller exemption pumpkin on December 31st. But it didn't turn out that way, did it?

Beth Kaufman: No pumpkins, Warren. Instead, what we've got is, watch for the air quotes here, permanent, higher exemptions from estate gift and generation skipping tax. So now for 2026, we've got a $15 million per person exemption. So, if we're talking about a married couple, 15 million for the one spouse and 15 million for the other spouse. What that means is that something like 99.8 percent of decedents will not be subject to estate tax. So when we're doing planning for people, we need to refocus and not think so much about estate tax for a good lot of people, but focus more on the income tax aspects, which might mean that a person holding onto their assets and getting a step-up and basis at death is a better outcome for the family than gifting appreciated assets would be.

Warren Racusin: So, in other words, in former times, we talked with clients a lot and still do with some of them about getting assets out of their estate during their lifetime to try to avoid bigger estate or gift tax to generations skipping hit on those. But now with the exemption being so high, and as you said, when you die, the basis of your assets for income tax purposes get stepped up to date of death value. Maybe that planning gets flipped on its head. Give us a quick example. I bought Microsoft stock at $2 a share. Now it's worth $100 a share. What happens if I give it away during my lifetime or what happens if I keep it until I pass away?

Beth Kaufman: Right. So, if you give that share of stock to your daughter, then she'll have your basis, your $2 basis in that stock. And as she wants to sell it, she would have a capital gain of $98 and pay capital gains tax on that. But if instead you hold that share of stock until you die and then bequeath it to your daughter, she would take it with its value on your date of death as its basis. And so, she'd get a $100 basis and then if she turned around to sell it, she wouldn't owe any capital gains tax at all. Now that may or may not be a good trade-off if you are an estate taxpaying decedent, but if you're out of the estate tax world because you and your spouse have assets of under $30 million, then it's going to be more of a tax win to hold onto that and leave it to her at death than it would be to give it to her while you're living.

Warren Racusin: What are a couple of other ideas that clients should be thinking about and people should be thinking about in light of this permanent increase in the estate tax exemption, Beth?

Beth Kaufman: So, another thing I think we should be concerned with for people who are now in that category where they're not going to pay any estate tax is to look at old estate planning and see if it's still relevant. So, I think a good example of that would be a client where one spouse has died and set up a trust to keep assets out of the surviving spouse's estate. And now when we look at the surviving spouse's estate, she is well under the estate tax limits. So, in that case, it might be better to devise a way to take those trust assets and get them back into her estate so that those assets would get a step-up in basis when she dies since there wouldn't be any additional estate tax triggered by doing that.

Warren Racusin: So again, planning in many ways flipped on its head from the way we used to think about things. Things are very different now with this large exemption in all but two tenths of one percent of the population free of estate tax.

Beth Kaufman: Exactly. But we need to remember, we also have many clients, most of our clients, who are still above that threshold for taxation. And for them, the planning techniques are all the same as they have been all along.

Warren Racusin: Right. And even for the 99.8 percent who are now freed from federal estate tax, there may be state estate taxes that they have to think about, right?

Beth Kaufman: Indeed, believe it or not, there are still 12 or 13 jurisdictions that have an estate tax or an inheritance tax, and that can really impact the planning that you do for someone because some of those states are following along with these federal increases, but quite a number of them are not. So, people residing in those states still need to pay attention to the lower cutoffs for estate taxes.

Warren Racusin: New York being a prime example, the exemption from estate tax in New York is only about $7 million. So, it's a very different universe to think about when you're thinking about New York estate taxes if you happen to be a New Yorker and haven't absconded for Florida or someplace else like that that doesn't have estate tax. And finally, portability, our old friend is still important, right Beth?

Beth Kaufman: Portability is still important. And in fact, I feel in some ways even more important because right now we have this really high estate tax exemption. And if someone dies while the exemption is as high as it is now and they haven't used their exemption and they can make a portability election, they give that amount of exemption to their surviving spouse. Now, just like when we were talking about permanence, since we don't really know what permanent is, if you make that portability election, you lock in that amount of exemption that you're giving to your surviving spouse. So, it's kind of like an insurance policy against the exemption going down and people should really think hard before they skip over that opportunity to save that exemption for the surviving spouse.

Warren Racusin: So as an example, if somebody dies this year when the exemption is $15 million, they should port or transfer their unused estate tax exemption to their spouse because if their spouse dies in a year when the exemption is only $5 million, I'm making this up, the surviving spouse will still have $20 million of exemption, the five million they have on their own ball, plus the

$15 million that was transferred to them by their deceased spouse during lifetime, right?

Beth Kaufman: Right. And let's say that surviving spouse has an estate of $10 million, they're going to save a lot of estate tax by having made that portability election if the exemption does go down at some time in the future.

Warren Racusin: Right, right. So, estate taxes are obviously exciting to Beth and me, but there's a whole other side of OB3, which is the income tax side that probably interests people as well. And there are a bunch of facets to that. Kristin, let's talk about some of those. First, let's knock out the real basic ones. Cop tax rate?

Kristin Taylor: Stays at 37 percent.

Warren Racusin: Instead of going up. Standard deduction?

Kristin Taylor: That has been increased by $750 per taxpayer to 15,750 for a single filer and 31,500 for married folks filing jointly. This amount is also now indexed for inflation.

Warren Racusin: So, the good news about that is that the exemption from income tax is higher. The thing to keep in mind is that if you have itemized deductions, unless they are more than $31,750, you're going to lose the benefit of that. And so, you need to plan for that.

Kristin Taylor: Exactly right.

Warren Racusin: No tax on tips, right?

Kristin Taylor: Yeah.

Warren Racusin: Kind of.

Kristin Taylor: Kind of. Starting in 2025, certain tipped workers can qualify for an above-the-line deduction. So, this is a deduction for non-itemizers, which can potentially lower taxable income by up to $25,000 per return. One thing to note here is that if you're married, you can still only deduct up to $25,000 per joint return, and you're disqualified from claiming this deduction if you file separately. So, if you have two tipped workers, you're still subject to that $25,000 limit, even if you file jointly. The devil is in the details, as with all things. First, the tips have to be reported to your employer and the IRS. And they're still subject to Social Security and Medicare payroll taxes, as well as any applicable state and local income taxes. Second, the allowable deduction starts to shrink by $100 for every thousand dollars of your modified adjusted gross income over $150,000 for single filers or $300,000 for joint filers.

Third, not every job that receives tips will be eligible. The Treasury Department has published a proposed list of occupations that customarily and regularly receive tips. And once that list is finalized, if your job isn't on the list, your tips will not qualify. In addition, certain job categories are just completely excluded. So professional service businesses, your accountants, your architects, your consultants are not eligible, even if they do occasionally receive tips. There's a category for illegal activity, which gets a little interesting when you think about businesses that are legal under state law, but not federal, such as marijuana related businesses. Lastly, there's a category for prostitution and pornography, which has not been defined, but depending on how it is ultimately drafted, may include certain online accounts through platforms like OnlyFans through which a number of people currently receive tips.

Warren Racusin: Are those terms actually in the statute?

Kristin Taylor: Yes. They've thought of everything.

Warren Racusin: Interesting drafting.

Kristin Taylor: Yeah. And then finally, this deduction is scheduled to sunset after 2028, unless Congress acts before then to extend the rule.

Warren Racusin: And you said professional services are excluded. So, the idea that I had at 3:00 in the morning of re-characterizing all of our bills as tips for ideas we gave out at a cocktail party is not going to cut it, right?

Kristin Taylor: No, this provision does no favors for the legal profession.

Warren Racusin: Right. How about that? Why should this be any different, right? Now, Beth, this I know is one of your favorites. I know you’re wound up and ready to go. No tax on Social Security benefits, right?

Beth Kaufman: Sure. And this one's not even permanent. What gets me going on this is that it's for marketing purposes, it's no tax on social security. But if you actually look at the statute, it doesn't say anything about social security. What it really is, is an additional personal deduction for individuals who are aged 65 or over and meet certain income limitations. If you're over 65, you don't even have to be on social security. You could be deferring your social security until you're 70, but you would still qualify for this additional deduction. The deduction is $6,000 per qualifying individual. So, unlike the one Kristin was just talking about, if you file married filing jointly here and both you and your spouse are over 65, you can have two of these. Now, for the income limitations, this benefit is phased out for single people with modified adjusted gross income between 75,000 and 175,000.

And if you're married filing jointly, that phase out occurs between 150,000 and 250,000 of modified adjusted gross income. So, what this effectively does, if you think of it as offsetting some of the tax on social security, prior to this law, about 64 percent of people did not pay any income tax on their social security, and after this, it's going to be more in the 80 percent range. This provision is temporary. It took effect in 2025, and it runs through 2028 and would take an act of Congress to extend this benefit past 2028.

Warren Racusin: So, the good news is that if you were 66 years old in 2025 and had deferred your social security payments until, I think 70 is the latest you can defer them, you still are eligible for the deduction even though you're not getting social security and that's going to show up on the returns that you file in April of '26, assuming you're underneath the caps, et cetera. Is that right?

Beth Kaufman: Right. As long as you qualify based on your income, yes.

Warren Racusin: So that's one that started even before 2026.

Beth Kaufman: And so did the tips.

Warren Racusin: And so did the tips.

Beth Kaufman: The tips were also effective for 2025.

Warren Racusin: Clearly designed to benefit lower income workers, lower income seniors, et cetera, et cetera. That obviously is the policy goal, how it gets you there and whether that policy is appropriate obviously is another issue, but clearly that's what they all had in mind when they enacted these rules. Let's talk about some of the little bit juicier stuff now. The world-famous SALT deduction. Kristin, first, remind everybody what SALT stands for.

Kristin Taylor: SALT stands for state and local tax. And just to give us a little bit of refresher as to what we're talking about, pursuant to tax law changes under the prior Trump administration, a limitation was imposed on the ability to deduct state and local taxes.

Warren Racusin: Before the limitation, you could take an unlimited deduction for your state and local income taxes, property taxes against your federal returns.

Kristin Taylor: That's exactly right.

Warren Racusin: Kind of a form of revenue sharing between the federal and the state government. The feds took a little less so the states could get a little more, right?

Kristin Taylor: That's exactly right. And then in 2017, as part of the Tax Cuts and Jobs Act or TCJA, that deduction was limited to $10,000. And this was obviously primarily impactful to and intended really to target high tax states, including New York, New Jersey, and California, and has been a political hot button issue since.

Warren Racusin: So, the cap is now increased to, you can take up to $40,000 of state taxes against your federal income tax, but there are some limitations to that also, right?

Kristin Taylor: That's right. It's subject to a phase down, which kicks in for taxpayers with modified adjusted gross income over $500,000, which ultimately at a full phase out reduces the deductible amount to $10,000. Both the limitation and that modified adjusted gross income threshold are increased by one percent each year through 2029, following which this increased limitation is scheduled to revert back to the original $10,000.

Warren Racusin: Right. So again, to overstress the metaphor, the $40,000 carriage turns back into a $10,000 pumpkin at that time.

Kristin Taylor: That is correct. Another bit of good news for those of us in high taxpaying states is that what has not changed is the ability for certain taxpayers who conduct business through partnerships or S corporations, so flow through entities, to take advantage of pass-through entity tax or PTET deductions that are available in certain states, including New York, New Jersey, and California, which were implemented as a workaround to the federal SALT deduction limitation. So that strategy still remains available.

Warren Racusin: Those were spared in this legislation.

Kristin Taylor: Correct.

Warren Racusin: Right. That's SALT. Let's talk about QSBS. In tax land, we love acronyms, although haven't come up with a good acronym for QSBS SALT. It's like Quiz Biz that doesn't really cut it. But anyway, what is it?

Kristin Taylor: Yeah. Also-

Warren Racusin: Tell us what it is.

Kristin Taylor: QSBS, also known as qualified small business stock or 1202 stock after the code section, which provides for this tax benefit, is generally stock of a US corporation that satisfies certain requirements. And the exciting thing is that a taxpayer who sells QSBS can potentially exclude from their taxable income all or a portion of that gain. Under prior law, a taxpayer who sold QSBS after holding it for at least five years could exclude the greater of $10 million or 10 times their basis in the QSBS, which is usually the amount they originally paid for the stock. Under the new rules, taxpayers can start to benefit from a partial gain exclusion earlier. There is a 50 percent exclusion rate for stock held at least three years, 75 percent for stock held at least four years, and a full exclusion kicks in at five years. In addition, the cap has increased to the greater of $15 million, which will be adjusted for inflation starting in 2027 or 10 times their basis. And then lastly, one of the requirements for qualified small business stock status, namely that the issuing corporation have aggregate gross assets below a certain threshold, has been made more favorable with the limit increasing from $50 million to $75 million, which will have the effect of allowing more businesses to potentially issue stock qualifying for this exclusion.

Warren Racusin: So, the original QSBS rules and this extension obviously were designed to promote entrepreneurship. At least that was the stated purpose by giving people a break. They create a successful company and then sell it, give them a break on their taxes to reward them for the fact that they hired people, they created something, they innovated, et cetera.

Kristin Taylor: That's exactly right. And also to encourage investors to make investments in small businesses in the United States.

Warren Racusin: Right. And the good news here in OB3 is that you no longer have to hold it necessarily for five years. You can start getting a partial break at three years and above, right? And plus, the cap on the amount that you can protect from taxes now increased from 10 million to $15 million.

Kristin Taylor: That is correct. Although I do want to flag one thing with respect to the years in which there's a partial exclusion, the non-excluded part of the gain will be subject to a 28 percent tax rate, which is higher than your normal long-term capital gain rate. And that's a result that I think taxpayers wouldn't necessarily expect.

Warren Racusin: Right, right. A lot of baby splitting going on in the backrooms on Capitol Hill to get this done. But the one thing, and I mentioned earlier that Kristin sits at the intersection of tax planning and estate planning, one of the things that is right at that intersection is something that Beth and I and the other folks in the group do with respect to QSBS that survived OB3 and is still very much part of the law, and that's what we sometimes call stacking and packing.

Kristin Taylor: Sure. So, for stacking, in general, you can transfer qualified small business stock by gift while preserving QSBS benefits for your beneficiary. And in addition, and this is what makes this an exciting strategy, not only does that beneficiary potentially get access to the gain exclusion, each beneficiary is subject to their own $15 million cap. So, you can essentially multiply the amount of potentially excluded gain by gifting it among family members or using trusts.

Warren Racusin: So, if I created the next Microsoft and I have $45 million worth of this stock and I have three children, I can get my own QSBS exemption, plus I can give $15 million worth of stock to my three children. Actually, that's where I get the $60 million. So, by using that strategy, you can eliminate the tax on most, if not all, of the capital gain. Plus, you've gotten that value out of your estate for estate tax purposes and all of its future growth won't be hit by the 40 percent estate tax.

Kristin Taylor: It's a win-win.

Warren Racusin: It's a win-win. It's a win-win-win. And again, we were pleasantly surprised that they didn't go after it because it has certainly gotten attention, right? Beth, but it survived, right?

Beth Kaufman: It has. One thing to point out is you want to make those gifts early on because if you wait until it's worth 15 million, three times 15 million, you're going to have a little hefty gift tax bill there.

Warren Racusin: That is correct.

Beth Kaufman: So, we like to see these people early in their planning to do this kind of setup for them.

Warren Racusin: Finally, let's talk about charitable planning, something that's near and dear to a lot of people's hearts, especially we're recording this in December, but certainly towards the end of the year when people are thinking about year and charitable gifts. There is some good news and some not so good news in OB3 about charitable planning. Kristin, since you're the rookie, you want to take the good news and then we'll give Beth the veteran the bad news side of it.

Kristin Taylor: Absolutely. So, in good news, beginning in 2026, an above-the-line deduction is added for charitable contributions that are made by taxpayers who do not claim itemized deductions. And this is limited to $1,000 for single filers and $2,000 for joint filers. One thing to note here is that this deduction is available only for cash gifts that are made for public charities and is not available for donations to donor-advised funds or certain supporting organizations. For taxpayers who do itemize their deductions, the good news there is that there have been some technical corrections that were made to language that was originally added to the code as part of the TCJA in 2017, such that it is now clear that cash contributions to public charities are deductible up to a limit of 60 percent of a taxpayer's adjusted gross income.

Warren Racusin: And by above-the-line deduction, do you mean it comes right off the top of your income? It's not subject to any kind of limitations that might otherwise be in the tax law. It just comes right off the top.

Kristin Taylor: That's correct. Similar to the standard deduction.

Warren Racusin: Right. Similar to the standard deduction. So Beth, turning to the not so good part, and I have to say, this is the part of the podcast that I have been waiting for where you explain the 2/37th rule, which I really can't wait to hear about. So have at it, please.

Beth Kaufman: All right. So, there are actually two ways in which OB3 carves back itemized deductions here. One, and again, these are the terms that we cool kids are using. We call the first one the shave. So, the shave applies to charitable contributions, and the way it works is that you compute 0.5 percent of your adjusted gross income. So, let's say your adjusted gross income is a million dollars. 0.5 percent of that would be $5,000. Therefore, the first $5,000 of your charitable contributions are simply not deductible. That's the shave. The other piece of this we're calling the haircut. And under the haircut, the benefit of your itemized deductions is limited to the tax benefit it would have if you were in the 35 percent tax bracket instead of the 37 percent tax bracket. So, what that means is that when you make your list of itemized deductions, let's say, let me make the math easy for myself, they total up to $1,000, but somehow they're deductible.

Okay. So of $1,000, your tax benefit against a 37 percent rate would be $370, but we're only going to let you have the benefit as if your tax rate was 35 percent, so that would be $350. It doesn't sound like much when I use those small numbers, but it can add up. So, what happens here, there are a couple of glitches in applying that 2/37th haircut. One is that there are people whose income exceeds the threshold for the 37 percent rate, but who don't actually pay tax at the 37 percent rate because of the types of income that they have.

So, let's imagine somebody who's retired and all of their income is coming from qualified dividends and capital gains, which are taxed at a 20 percent rate. There's no carve out from this for them. So even though the purpose of this haircut was to limit people to the same deduction they'd get if they were in the 35 percent rate, people who are in fact paying tax at 20 percent are subject to the same 2/37th haircut. It seems inconsistent with the policy behind this new legislation, but there is nothing in this law that lets those people be excluded from the haircut.

Warren Racusin: And whether that was just an effort to get the math to work and the budget economics to work, or whether it was just a mistake, I'm not sure that we know, or maybe we do know.

Beth Kaufman: I don't think we really know. The other question people have been asking is, "Well, might we get a technical correction to fix it?" Of course, that's always a possibility. Do I think that's probable? Probably not. We might guess the rumblings we've heard here in Washington, D.C. are that there isn't much interest in doing any technical corrections for OB3 because it's so perfect and big and beautiful. So, we're not holding our breath for a technical correction on that. But there's another issue here too, Warren, and that is we've had a haircut on itemized deductions before. For those who've been in the tax world for a while, it was something that everybody called Pease, which had nothing to do with the green things in a pod and everything to do with someone in Congress who was Mr. Pease. Okay, so-

Warren Racusin: With an E at the end.

Beth Kaufman: P-E-A-S-E, Pease. Yes. So, when we had Pease, there was a specific provision in the code that said, "This doesn't apply to trusts and estates." Yay, we got that get out of jail free card for trust and estates. In OB3, they expressly repealed that exception for trust and estates. So therefore, we conclude, okay, this haircut does apply to trusts and estates. And then when you look at how they define itemized deductions, it's basically everything that you deduct. Now, if you think about that in the context of trusts and estates, one of the big deductions that trusts an estate have is the distribution deduction, and the purpose of the distribution deduction is to avoid double taxation. So, in other words, if a trust or an estate has income, if it holds that income and doesn't distribute it, then the trust or estate pays the income tax on it.

If it instead distributes the income to a beneficiary, then the trust for estate gets a deduction for that amount and the beneficiary includes it in their income. So, it's kind of a closed system. Either the trust or estate is paying the tax or the individual is paying the tax, but that distribution deduction now appears that it's going to be subject to the haircut. And that means we're going to have some degree of double taxation on trust income if it's distributed because the deduction that the trust gets is not going to be as large as the income that the beneficiary's going to have to include.

Warren Racusin: So, for everybody listening, we're going to be distributing a test shortly after this for you to answer the questions about how the 2/37th rule works in the context of—No, well, I'm just kidding—but I think that's an example of number one, Congress trying to do so much that some stuff get lost in the details or maybe not. We don't know, but it seems like some things get lost in the details. Even more importantly, from our perspective, it goes to the fact that this stuff isn't as simple as it seems on the surface. And if you're at any level of wealth, any level of income, if you're starting to think about how to plan for the One Big Beautiful Bill, you need to get some advice to make sure that to navigate through these twists and turns. And it's great for me to have folks like Kristin and Beth to help me navigate through it with clients.

And we've just scratched the surfaces, which is all we can do in a podcast like this. But I think hopefully we've sensitized people to a little bit of the advantages, the opportunities, and some things you need to think about. Beth Kaufman, Kristin Taylor, thanks so much for your insights today. Thanks for everybody, Good2bSocial, and Chris Johnson, and all our team here at Lowenstein for helping to put these together. We will see you next time, till then as we say in these parts, have a good one.