End of 2025 Planning

Take-Away: The One Big Beautiful Bill Act (OB3) contains many new provisions, some of which are effective in 2025. Some planning steps can be taken before the end of 2025 to take advantage of these new provisions, primarily tax deductions.

Background: The OB3 provides many new provisions and changes to existing laws that have different 'start' dates. Some of the new provisions and opportunities begin in 2025, which might be beneficial for this year's tax obligation. However, many of the new tax deductions also come with income phase outs of the deduction, and those phase out ranges differ depending on the tax deduction. Some of those 2025 planning opportunities or considerations follow.

Use 529 Accounts: The OB3 permits 529 distributions up to $20,000 of K-12 related expenses and credentialling costs, effective for distributions made after July 4, 2025. However, 529 funds can be used to reimburse expenses incurred at any time during 2025, as along as the distribution is made before the end of the calendar year. Consequently, this permits individuals a one-time opportunity to reimburse themselves from a 529 account for previously ineligible education expenses incurred earlier in the 2025 calendar year.

Exploit Remaining Energy Credits: The OB3 accelerates the expiration of some energy credits that were introduced under the Inflation Reduction Act. While the credits for electric vehicles have since passed, there is still time for qualifying energy efficient home improvements to receive a tax credit of up to $3,200, e.g., energy efficient windows, doors, or even the cost of a home energy audit.

Avoid the Charitable Deduction 'Haircut:' The OB3 limits a charitable deduction for high earners in the 37% marginal income tax bracket, starting in 2026. That limit, or 'haircut' is 2/37th of the individual's itemized deductions, including any charitable deduction. Because that new rule comes into effect in 2026, high earning individuals might benefit from 'frontloading' their charitable giving into 2025 to avoid this new limitation, such as by funding a donor advised fund (DAF) in 2025, to preserve flexibility in their future grant making.

Exercise Incentive Stock Options: Starting in 2026 the phase out threshold for the alternative minimum tax (AMT) exemption drops, while the SALT deduction cap rises to $40,000, which increases the risk of triggering the AMT for many incentive stock option (ISO) exercises. Accordingly, these changes narrow the window for an individual with unexercised ISOs to act in 2025 in order to avoid, or reduce, their AMT exposure in 2026.

Qualified Business Income: While the OB3 retained most of the qualified business income (QBI) deduction rules, it widens the Specific Service Trades or Businesses (SSTBs) income phase out range in 2026 for self-employed individuals. Consequently, SSTB owners whose income falls within the current 2025 phase out range may want to defer income into 2026 if possible, so the spike in marginal tax rates on QBI through the phase out range will be more gradual. Alternatively, those individuals whose income already exceeds the 2025 phase out limits could fall within the expanded 2026 rate, and thus they may benefit from accelerating their income into 2025 to avoid an increase in marginal income in 2026.

Roth Conversions and New Deductions: Many of OB3's new temporary below-the-line deductions for seniors, tip earners, overtime workers, and the auto loan interest deduction, adds complexity to planning for the period of 2025 to 2028. This principally deals with serial Roth IRA conversions and withdrawal strategies employed between 2025 and 2028. Each of these new income tax deductions phases out over a different income threshold, such that a Roth IRA conversion could unintentionally curb, or limit one or more of these deductions. Existing Roth IRA conversion strategies will need to be reviewed in light of these new deduction phase out rules.

Conclusion: The 'start' date for some of the changes arising in the OB3 provide a narrow set of opportunities for tax planning in 2025. Starting next year we are all going to have to become familiar with all of the OB3's new income tax deductions, including their different income phase out rules as we help others to plan their federal taxes.

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