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Perspective from
Franklin Templeton Wealth Planning

Key planning ideas to maximize your 2025 tax savings

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Given the uncertainty around the future of tax policy, it is difficult to estimate where tax rates are headed.

Still, with the growing national debt and increases in the federal budget deficit over time, the government may decide to increase revenue in the future with higher tax rates. Tax rates are already scheduled to increase after most of the provisions of the Tax Cuts and Jobs Act (TCJA) expire at the end of 2025. While Congress is currently pursuing an extension of the tax cuts, it's not certain what that may look like.

There may be steps taxpayers can take today to better manage their current tax bill or to hedge the risk of future higher tax rates. The first half of the year may be an opportune time to assess finances and determine if adjustments are needed and consider some new ideas for tax-efficient planning.

Here are five income tax planning strategies to consider for 2025.

Consider Roth IRA conversions

A thoughtful strategy utilizing Roth conversions can be an effective way to hedge against the threat of facing higher taxes in the future. Lower tax rates now translate to a lower cost for converting Traditional IRA assets to a Roth IRA. It is virtually impossible to predict tax rates in the future, given uncertainty in Congress, or to have a good idea of what your personal tax circumstances will look like years from now. Like all income from retirement accounts, Roth income is not subject to the 3.8% surtax and is also not included in the calculation for the $200,000 income threshold ($250,000 for couples) to determine if the surtax applies. Additionally, qualified tax-free distributions from a Roth account may help a taxpayer avoid certain income thresholds. For example, being subject to higher Medicare Part B premiums in retirement. IRA owners considering a conversion to a Roth IRA should carefully evaluate that transaction since the option to recharacterize, or undo, a Roth IRA conversion is no longer available. And for some taxpayers with a likelihood of being in a much lower tax bracket in retirement, a conversion may not make sense. That's why it's critical to consult with a qualified financial or tax professional on your particular situation.

Explore alternative ways to fund Roth accounts

Taxpayers at higher income levels are prohibited from contributing directly to Roth IRAs. For 2025, income phaseouts begin at $150,000 ($236,000 for married couples filing a joint return). Taxpayers may want to consider funding a non-deductible (i.e., after-tax) IRA and then subsequently converting it to a Roth IRA. There are no income restrictions on Roth IRA conversions. However, adverse tax consequences, referred to as the "pro rata" rule, may apply if the individual owns other pre-tax IRAs (including SEP-IRA or SIMPLE IRA). In short, if an individual holds a mix of pre-tax and after-tax IRA funds and is considering a conversion, the amount converted to a Roth will consist of a pro-rata mix of their pre-tax and after-tax savings. You cannot choose to just convert after-tax IRA funds while disregarding your pre-tax IRA funds. Before considering this strategy, taxpayers should consult with their tax professional.

Also, participants in 401(k) plans may be able to make voluntary after-tax contributions into their plan in excess of their salary deferral limit ($23,500 for 2025). When allowed by the plan, after-tax contributions may be directly transferred to a Roth IRA without any income tax consequences upon a plan triggering event. This may be a strategy for higher-income taxpayers to diversify their tax liability in retirement. For more details on how this strategy works, see our recent article "Turning after-tax contributions into tax-free retirement income." *(See https://www.franklintempleton.com/articles-us/retirement/turning-after-tax-plan-contributions-into-tax-free-retirement-income.)*

Maximize deductions in years when itemizing

With the large increase in the standard deduction under recent tax law changes, and the scale back of many popular deductions, fewer taxpayers choose to itemize on their tax returns. Some taxpayers may benefit by alternating between claiming the standard deduction for some years and itemizing deductions for other years. If possible, it would make sense to "lump" as many deductions into those years when itemizing. For example, taxpayers may want to consider making a substantial charitable contribution during a tax year when itemizing instead of making regular, annual gifts. Or, scheduling certain procedures to lump deductible medical expenses in one year.

Consider the charitable rollover option

IRA owners (age 70½ and older) may benefit from directing charitable gifts tax-free from their IRA. Since more taxpayers claim the higher standard deduction since it doubled in 2018, they do not benefit tax-wise from making those charitable gifts unless they itemize deductions. Account owners are limited to donating $108,000 in 2025, which can include the required minimum distribution (RMD), and the proceeds must be sent directly to a qualified charity. Distributions to a donor advised fund or private foundation are not eligible.

Maximize the 20% deduction for qualified business income (QBI)

As a result of tax changes in 2017 many business owners are eligible to deduct 20% of their qualified business income (QBI) on their tax return. Business income from pass-through entities such as sole proprietorships, partnerships, LLCs and S-corps may qualify for this deduction. Certain types of businesses—defined as a specified service trade or business (SSTB)—may be limited from taking the deduction based on the taxpayer's household taxable income. The deduction is subject to a phaseout for SSTBs once income exceeds $197,300 ($394,600 for married couples filing a joint return). SSTBs include businesses performing services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services and certain brokerage services. Business owners impacted by the income phaseout may want to consider strategies to reduce taxable income, such as funding retirement accounts, deferring income or accelerating business expenses.

Seek advice

Consult a qualified tax or legal professional and your financial advisor to discuss these types of strategies to prepare for the risk of higher taxes in the future. Personal circumstances vary widely, so it is critical to work with a professional who has knowledge of your specific goals and situation.

For more planning strategies, see "Ten income and estate tax planning strategies for 2025." *(See https://franklintempletonprod.widen.net/s/htkmldcnht/ten-income-and-estate-tax-planning-strategies-for-2024-flyer-ietps-fl.)*

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