

THOUGHT LEADERSHIP

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Maximizing Tax Advantages: Remember the 65-Day Rule's March Deadline

How many times have you prepared your income tax returns for the previous year, only wishing you knew then what you came to know later, so you could go back and make more advantageous tax decisions? In most cases, you are stuck with the decisions you made before the new tax year began, even though you may not have all the relevant tax information available to assist with those decisions until several months into the new tax year. Too bad, says the IRS, **unless you are an estate or trust.**

Under Section 663(b) of the Internal Revenue Code, any distribution by an estate or trust within the first 65 days of the tax year can be treated as having been made on the last day of the preceding tax year. For example, a distribution of \$700 of trust income by the trustee to a beneficiary on January 20, 2025, can be treated as having been made in the 2024 tax year **or** the 2025 tax year. In most years, including 2025, the last day to make a distribution count toward the previous tax year is **March 6.**

The election to treat the distribution as being made in the previous tax year must be made by the fiduciary on a timely filed income tax return (including extensions) for the tax year to which the distribution is meant to apply. A fiduciary may make the election for only a partial amount of the distribution(s) within the 65-day period, but once made, the election is irrevocable.

The main advantage of this tax rule is that it may provide an opportunity for tax savings. An estate or trust pays income taxes at graduated rates similar to individuals, but for 2024 the top tax rate (37%) applies to ordinary income above \$15,200. Comparatively, married couples filing jointly pay the top rate when income exceeds \$731,200 (or \$609,350 for single filers). In some cases, an additional 3.8% Medicare surtax (also known as the Net Investment

Income Tax) on the net investment income of the estate or trust may apply, resulting in a total marginal tax of 40.8%. To avoid paying such a high tax rate, income may be distributed to a beneficiary from the estate or trust, and the beneficiary (rather than the estate or trust) will then pay any income taxes associated with the distribution at the beneficiary's individual tax rate. For example, a beneficiary who pays income taxes at a rate of 24% would pay less income tax on the distribution amount than a trust already paying at the top rate of 37% (or even 40.8%). In cases of estates or trusts with large taxable income and beneficiaries in lower tax brackets, the tax savings can be significant.

State income tax consequences may also apply to distributions made from a trust or estate, and there may be limitations on the amounts of distributions a fiduciary can apply using the 65-day rule. It is recommended that you discuss all possible consequences with your tax advisor before trying to apply the rules discussed above.