How to Use the 65-Day Rule to Cut Trust Taxes

If you're involved in managing a trust or are a beneficiary, understanding how the 65-day rule works can help you with effective tax planning.

The 65-day rule is also known as the 663(b) election. It allows trustees of complex trusts to make distributions to beneficiaries within the first 65 days of the new tax year and elect to treat these distributions as if they were made in the previous tax year.

So why is this important? Trusts reach the highest tax bracket of 37% at just $15,200 of income. In contrast, individuals don't hit that rate until their income exceeds $751,600. By distributing income to beneficiaries in lower tax brackets, the overall tax liability can be significantly reduced.

Imagine a trust earned $20,000 in 2024, placing it in the top tax bracket. If the trustee distributes that income to a beneficiary in a lower tax bracket by March 6, 2025 and makes the 65-day election, the income is taxed at the beneficiary's lower rate for 2024, resulting in tax savings. However, this strategy isn't for all trusts. It's specifically for complex trusts, meaning those not required to distribute all income annually. Simple trusts and grantor trusts don't qualify.

To make the 65-day election, trustees need to indicate this choice on IRS Form 1041 when filing the trust tax return. You should consult with a tax professional to ensure compliance and optimal tax outcomes.

The 65-day rule offers a valuable opportunity for tax planning and complex trusts. By understanding and appropriately applying this rule, trustees can make informed decisions that benefit both the trust and its beneficiaries. For personalized advice, always consult with your tax advisor.