Trustees and Beneficiaries Can Save Taxes with the "65-Day Rule"

02.12.19

Executors of estates and trustees of complex trusts may have an opportunity to reduce 2018 income taxes. Trusts and estates begin paying taxes at the top federal rate of 37.0% when 2018 taxable income exceeds $12,500. In addition, interest, dividend, net capital gains, and other investment income is subject to the 3.8% net investment income tax, resulting in a total federal marginal tax rate of up to 40.8%. Personal federal taxes for 2018 do not reach the top tax bracket of 37.0% until taxable income exceeds $500,000 for single filers or $600,000 for married, joint filers. Individuals are also subject to the 3.8% tax on net investment income tax at $200,000 - $250,000 of modified adjusted gross income.

The TCJA of 2017 has suspended federal investment expense deductions, which may increase the trust's 2018 income. The TCJA has also created a federal Qualified Business Income deduction (Section 199A). When Section 199A is applicable and trust distributions are made, the deduction is shared with the trust's beneficiaries.

Income distributions made by the estate or trust to beneficiaries in a lower tax bracket during the tax year may result in overall tax savings. If the fiduciary of a calendar year estate or trust wishes to increase distributions to the beneficiaries in order to have more 2018 income taxed to them, there is still an opportunity to make distributions after December 31, 2018, using the "65-Day Rule".

The "65-Day Rule" (IRC §663(b)) allows the fiduciary to designate some or all of the distributions made in the first 65 days of the following tax year as paid in the prior tax year. This means that distributions made through March 6, 2019, can be used to shift 2018 taxable income to beneficiaries. The election allows the executor or trustee more flexibility and time to evaluate income and to make the decision regarding the potential tax savings of additional distributions.