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COST OF ESTATE TAX COMPLIANCE DOES NOT APPROACH THE TOTAL LEVEL OF ESTATE TAX REVENUE

By Joel Friedman and Ruth Carlitz

It has been claimed that the costs of complying with the estate tax are nearly equal to the total amount of revenue the tax raises. While it is true that wealthy people devote considerable time and money to sheltering their estates from taxation, there is no credible evidence that compliance costs — including the IRS' costs of administering the estate tax and the cost taxpayers bear in terms of estate planning and administering an estate when a person dies — carry a cost anywhere near the estate tax revenue yield.

- **The cost of estate tax compliance is about 7 percent of estate tax revenues.** In a detailed study, Rutgers University law professors Charles Davenport and Jay Soled estimated all the various public and private costs associated with estate tax compliance.¹ The authors estimated that these costs represented about 7 percent of estate tax receipts in 1999. An analysis by Duke University law professor Richard Schmalbeck came to similar conclusions.²

Both of these analyses relied heavily on surveys of lawyers and accountants involved in estate tax planning. One of the key findings was that about half of the costs normally associated with estate tax planning and administration would still be required even if the tax were repealed. For example, activities such as selecting executors and trustees, drafting provisions and documents for the disposition of property, and allocating bequests among family members would still have to be undertaken in the absence of an estate tax.

- **Estate tax compliance costs are consistent with the costs for other taxes.** The estimates cited above put estate tax costs in the same range as the administrative and compliance costs associated with other taxes. For instance, in recent testimony before the House Ways and Means Committee, University of Michigan economist Joel Slemrod stated that administrative and compliance costs represent about 14.5 percent of revenue for the individual and corporate income taxes.³ In another analysis, he indicated that compliance

¹ Charles Davenport and Jay A. Soled, "Enlivening the Death-Tax Death-Talk," *Tax Notes*, vol. 84, July 26, 1999.

² Richard Schmalbeck, "Avoiding Federal Wealth Transfer Taxes," *Rethinking Estate and Gift Taxation*, William G. Gale, James R. Hines, Jr., and Joel Slemrod, eds., The Brookings Institution, 2001.

³ Joel Slemrod, "Testimony Before the Committee on Ways and Means Hearing on Tax Reform," June 8, 2005.

costs represent about 3-5 percent for value added taxes and 2-5 percent for the sales tax.⁴ Both Schmalbeck and Davenport-Soled conclude that the estate tax is an “efficient” tax.

The claim that the cost of complying with estate tax laws is roughly the same magnitude as the revenue collected is often linked to a 1992 paper by the economists Henry Aaron and Alicia Munnell.⁵ At that time, Aaron and Munnell wrote that compliance costs represented a “sizable fraction” of total revenue.

Opponents of the estate tax have frequently exaggerated the implications of these findings, which reflected rough estimates and were not based on the type of surveys that have informed more recent analyses. Further, since the estimates were first made, estate tax revenue has grown more quickly than estate planning costs, rendering the estimates seriously out of date and of limited value for informing the current estate tax debate.⁶

Notably, Aaron recently told the *New York Times* that he does not now believe that estate tax compliance costs approach estate tax revenue. He also noted that both he and Munnell “believe in principle that large transfers of wealth should be taxed,” especially because the estate tax serves as a backup to the income tax, levying tax on concentrations of wealth that might otherwise escape taxation altogether.⁷

Aaron further noted that modest increases in the estate tax exemption level, such as are occurring under current law, sharply reduce the total compliance cost of the estate tax. Already in 2006, the estate tax exemption has risen to \$2 million (\$4 million per couple) and in 2009 it will rise further, to \$3.5 million (\$7 million per couple). As a result, the compliance burden associated with the estate tax will disappear altogether for a growing number of families each year under current law. Internal Revenue Service data show that the number of estates that filed estate tax returns between 2000 and 2003, a period in which the exemption level rose from \$675,000 to \$1 million, declined by some 40 percent. As the exemption rises further, even fewer estates will have to file an estate tax return or engage in other compliance activities arising from the estate tax. Those estates that have sufficient wealth to be subject to the tax under the higher exemption levels will still face considerable compliance costs, but these costs primarily reflect the extent and complexity of their financial affairs. Nevertheless, as part of a reform process, steps should be taken to simplify the tax in ways that would further ease the compliance burden.⁸

⁴ Joel Slemrod, “Which is the Simplest Tax System of the Them All?” *Economic Effects of Fundamental Tax Reform*, Henry Aaron and William Gale, eds., The Brookings Institution, 1996.

⁵ Henry Aaron and Alicia Munnell, “Reassessing the Role for Wealth Transfer Taxes,” *National Tax Journal*, June 1992.

⁶ See William G. Gale and Joel Slemrod, “Rhetoric and Economics in the Estate Tax Debate,” *National Tax Association Spring Symposium*, Washington, DC, May 7-8, 2001; Schmalbeck also reaches a similar conclusion.

⁷ David Cay Johnston, “A Boon for the Richest,” *New York Times*, June 7, 2006.

⁸ For a discussion of various simplification proposals, see the American Bar Association Task Force on Federal Wealth Transfer Taxes, “Report on Reform of Federal Wealth Transfer Taxes,” 2004.