

# ISSUE BRIEF

Note: a previous version of this paper incorrectly included filing burdens associated with Form 1041, which is more properly attributed to ordinary income tax compliance. This update paper has removed that data and has been edited for clarity.

## **Death and a Thousand Paper Cuts: The Compliance Burden of the Estate Tax**

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By Demian Brady

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The financial burden of the death tax is well known. This unwise and unfair tax is estimated to swipe \$23.1 billion per year from the wallets of Americans this year, many of whom operate family farms and other small businesses. What is less well known is the tremendous time and financial burdens associated with complying with the tax.

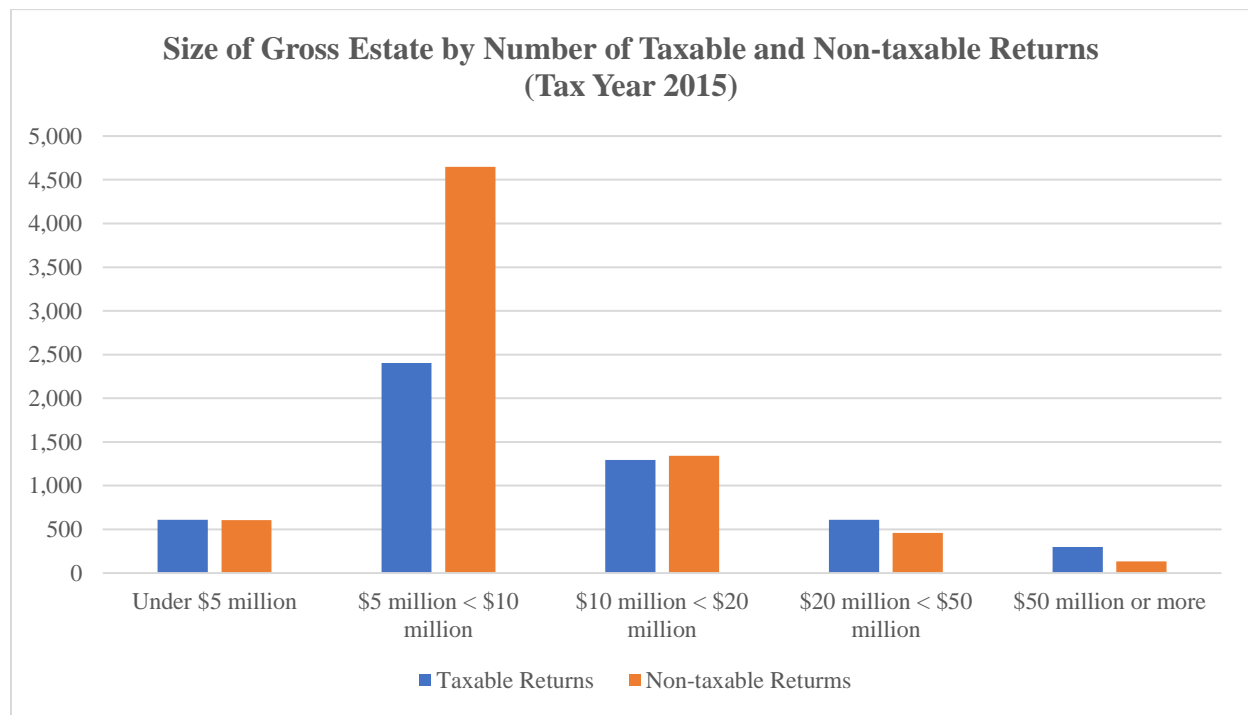
The Office of Management and Budget’s Information Collection Budget of the United States Government [tracks](#) the burden of hours spent complying with federal forms and other paperwork mandates.<sup>1</sup> The table below shows complying with the estate and gift tax through Form 706 – as well as additional forms related to the tax and regulatory reporting requirements – totals 2.1 million hours.

<b>Annual Burden Hours of Estate and Gift Tax Forms and Reporting Requirements</b>	
<b>Estate &amp; Gift Tax Forms</b>	<b>Total Annual Burden Hours</b>
Form 706 & Schedules - United States Estate (and Generation-Skipping Transfer) Tax Return	2,048,710
Application for Extension of Time to File a Return and/or Pay United States Estate (and Generation-Skipping Transfer) Taxes	30,710
TD 8162 - Income, Gift and Estate Tax (PS-102-88)	6,150
TD 8686 (Final) Requirements to Ensure Collection of Section 2050A Estate Tax (TD 8686)	6,070
Form 706-NA - United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of nonresident not a citizen of the United States	3,584
Form 706-A - United States Additional Estate Tax Return	1,678

Form 4422 - Application for Certificate Discharging Property Subject to Estate Tax Lien	1,500
Form 13925 - Special Lien for Estate Taxes Deferred Under Section 6166 or 6166A	500
Form 706-QDT - United States Estate Tax Return for Qualified Domestic Trusts	357
<b>Total Annual Burden Hours</b>	<b>2,099,259</b>
<i>Note: A previous version of this table incorrectly included filing burdens associated with Form 1041, which is more properly attributed to ordinary income tax compliance.</i>	

This is time spent complying with tax laws that could otherwise be devoted to more productive pursuits. A value can be assessed to this time by comparing it to the average compensation of private sector workers. The Bureau of Labor Statistics reported this June that professionals and managers received an average of [\\$58.90](#) per hour in salary and benefits.<sup>2</sup> Thus, the total compliance cost of the estate tax is \$123,646,355. In 2016, there were 12,411 [estate tax filers](#), meaning the compliance burdens associated with filing amounts to nearly \$10,000 per filer, regardless of their ultimate tax liability.<sup>3</sup>

This is a hefty compliance burden for a tax that generates just 0.7 percent of all federal revenues, and especially so since 59 percent in 2015 and 58 percent in 2016 of the roughly 12,000 yearly estate tax returns were ultimately non-taxable.



The estate tax exemption amount was pegged to inflation starting in 2012 and currently stands at \$5.49 million for 2017. Because the exemption has increased, somewhat fewer smaller family-owned businesses and farms are subject to the death tax, but that is of little consolation to those who still must fill out its tax forms. Many “land rich and cash poor” small family farms find themselves hit by the tax because of the valuation of land, crops, livestock, buildings, machinery and other assets that make up estates. The Department of Agriculture [reports](#) that small family farms are significantly more likely to be required to file an estate tax return and to have an estate tax liability than midsize and large-scale farms, despite ultimately producing less in revenue.<sup>4</sup>

Moreover, business owners and farmers undertake steps to protect their assets and minimize the sting of the death tax. One option is to restructure. As Scott Drenkard of the Tax Foundation [pointed out](#):

The estate tax also encourages firms to structure as corporations instead of as family businesses, because corporations do not pay estate taxes when the person at the helm changes ... [t]his observation should be disconcerting to left-leaning voters, who recognize that smaller, family businesses have ties to their communities, but it should also concern right-leaning voters, who should see this as a distortion of the market process.<sup>5</sup>

There are other options as well for business owners and farmers to make use of federal allowances and programs enacted to reduce the effective rate of the death tax. But due to the complexity of estate tax laws and regulations, it is highly advisable that they seek the advice of a tax professional. The amount of time and money devoted to planning is not captured in the IRS data. In this year’s edition of Family Enterprise USA’s annual [survey](#) of family-run businesses, owners reported spending 13 percent of their time on average in 2016 planning for the estate tax and “incurred an average of \$74,940 in insurance for estate taxes, [and] an average of \$170,800 in other estate tax planning costs.”<sup>6</sup>

In total, millions of dollars are spent each year on accountants and tax attorneys to plan for the estate tax and to minimize its impact – a deadweight loss of funds that could otherwise be used to invest in new products and services, expand entrepreneurship, and grow the economy. In the Family Enterprise USA survey, owners were asked what they would like lawmakers to know about the impact of estate taxes on their business. A common theme in the replies was that time and resources spent worrying about the estate tax detracts from their ability to grow their businesses. One owner [responded](#), “Estate taxes stifle growth and development, as well as impact succession possibilities that could allow a business to successfully transition ownership from generation to generation, and serve communities in perpetuity.”<sup>7</sup> Economic analysis of the death tax confirms that it weighs down job creation: the Tax Foundation estimated that repealing the estate tax would [boost the economy by 0.9 percent](#).<sup>8</sup>

Many of those who seek to minimize their tax liability and to preserve the ability to pass along their wealth to their designated heirs do so by establishing estates and trusts. One benefit is that their estate will be able to avoid probate court and fees, but they must plan carefully due to a complicated tax regime. Form 1041 is used to report the income, deductions, gains, and losses of estates and trusts, and the distributions to beneficiaries. Heirs also need to be aware of the tax consequences of the trust or estate that is set up. If the entity directly requires that income is distributed to individuals, that must be reported on Schedule K-1 and the beneficiary is responsible for paying the income taxes. If the administrator of the

trust or estate issued a discretionary income distribution, then the trust or estate is responsible for paying the income tax on that income, not the beneficiary.

The time spent complying with ordinary income taxes on estates and trusts (as opposed to actual estate tax liability) totals an astonishing 311 million hours, imposing an economic cost of \$18.3 billion. Furthermore, in [2014](#) just 27 percent of estate and trust returns ultimately had a tax liability, meaning that over \$5,700 in compliance costs on average were imposed on each of 3.2 million filers only to have greater than two of every three owe no tax in the end.<sup>9</sup>

Worse than the hassles of planning are the hassles of not planning. The late musician Prince is an example of this. He left behind an estate worth \$300 million but no will, condemning much of his wealth that he must have wished would go to family to be swallowed up by taxes and lawyer fees instead. This is a warning for the estimated 31 percent of family businesses that have [no estate plan](#).

The Treasury Inspector General for Tax Administration's recent [audit](#) found that the Internal Revenue Service needs to do a better job of processing and examining estate and gift tax returns.<sup>10</sup> But there may be an easier solution on the way: The Republicans' tax reform framework would [eliminate](#) the estate and gift tax.<sup>11</sup>

NTUF's Andrew Wilford [explored](#) several of the reasons why the death tax should be repealed, including that it is poorly targeted and discourages growth.<sup>12</sup> But as this brief paper shows, it is also tremendously inefficient, imposing significant compliance costs for relatively little revenue. Ending the estate tax would save jobs, spur growth, and cease the lamentable practice of taxing family grief.

### About the Author

Demian Brady is the Director of Research for the National Taxpayers Union Foundation.

### Notes

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<sup>1</sup> Office of Information and Regulatory Affairs, *Inventory of Currently Approved Information Collections*. Accessed October 11, 2017 at <https://www.reginfo.gov/public/do/PRAMain>.

<sup>2</sup> Bureau of Labor Statistics, *Employer Costs for Employee Compensation – June 2017*. <http://www.bls.gov/news.release/pdf/ecec.pdf>.

<sup>3</sup> Internal Revenue Service, *SOI Tax Stats - Estate Tax Statistics Filing Year Table 1*. Accessed October 19, 2017 at <https://www.irs.gov/statistics/soi-tax-stats-estate-tax-statistics-filing-year-table-1>.

<sup>4</sup> United States Department of Agriculture, *Federal Estate Taxes*. Accessed October 19, 2017 at <https://www.ers.usda.gov/topics/farm-economy/federal-tax-issues/federal-estate-taxes/>.

<sup>5</sup> Drenkard, Scott, *Why Progressives Should Want to End the Estate Tax, Too*, HuffPost, November 13, 2012. [https://www.huffingtonpost.com/scott-drenkard/estate-tax-repeal\\_b\\_1882227.html](https://www.huffingtonpost.com/scott-drenkard/estate-tax-repeal_b_1882227.html).

<sup>6</sup> Family Enterprise USA, *2017 FEUSA Family Business Survey*, March 2017. [http://www.familyenterpriseusa.com/wp-content/uploads/2017/03/F00183\\_2017\\_FEUSA\\_Family\\_Business\\_Survey\\_Report.pdf](http://www.familyenterpriseusa.com/wp-content/uploads/2017/03/F00183_2017_FEUSA_Family_Business_Survey_Report.pdf).

<sup>7</sup> Ibid.

<sup>8</sup> Cole, Alan, *Details and Analysis of Donald Trump's Tax Plan, September 2016*, Tax Foundation, September 19, 2016. <https://taxfoundation.org/details-analysis-donald-trump-tax-plan-2016/>.

<sup>9</sup> Internal Revenue Service, *SOI Tax Stats - Fiduciary Returns - Sources of Income, Deductions, and Tax Liability, by Tax Status and Size of Gross Income*. Accessed October 19, 2017 at <https://www.irs.gov/statistics/soi-tax-stats-fiduciary-returns-sources-of-income-deductions-and-tax-liability-tax-status-and-size-of-gross-income>.

<sup>10</sup> Treasury Inspector General for Tax Administration, *Improvements Are Needed in the Estate and Gift Tax Return Examination Process*, September 26, 2017. <https://www.treasury.gov/tigta/auditreports/2017reports/201730081fr.pdf>.

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<sup>11</sup> Wilford, Andrew, *Off to the Races on Tax Reform*, National Taxpayers Union Foundation, September 27, 2017.  
<https://www.ntu.org/foundation/detail/off-to-the-races-on-tax-reform>

<sup>12</sup> Wilford, Andrew, *Tax Reform Should Finally End the Death Tax*, National Taxpayers Union Foundation, August 24, 2017.  
<https://www.ntu.org/foundation/detail/tax-reform-should-finally-end-the-death-tax>,