

<p>GOOD NEWS-BAD NEWS: ESTATE TAX AUDIT RATE INCREASING DRAMATICALLY AS THE ESTATE TAX EXEMPTION INCREASES</p>

Summary:

Since the tax law was liberalized for estates in 2001, the number of federal estate tax returns filed with the IRS has been decreasing. As a natural corollary, there's been a corresponding increase in the Internal Revenue Service's audit coverage rate of estate tax returns. The leap this year to a \$3.5 million estate tax exemption from the previous \$2 million exemption will be the sharpest single-year increase in the estate tax exemption, both in terms of a dollar amount increase and on a percentage basis, since the modern estate tax was enacted in 1916. If there are still 270 IRS estate tax auditors, the audit rate for combined taxable and non taxable federal estate tax returns will have increased to almost 50%, and the audit rate for taxable returns will approach 100%. The audit rates for taxable and non taxable estate tax returns are dramatically higher than the 1 percent to 2 percent audit rate for individual income tax returns. Put another way: with the number of filed returns decreasing, the odds that a taxable estate tax return will be audited are rising from 20 percent to almost 100 percent.

Analysis:

The IRS website at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96442,00.html> shows that under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the number of estates required to file a federal estate tax return (Form 706) since 2001 has been steadily declining nationwide. It went from an annual total of 108,071 returns filed, to 38,031 returns in 2007. New Yorkers filed 7,157 of the 2001 returns, and 2,998 of the 2007 returns. Floridians filed 9,197 and 3,620, respectively.

Along with filed returns, the number of estates fitting the more liberal definition of "taxable" has fallen proportionately from a high of 51,736 in 2001, to 17,416 in 2007. IRS projections indicate that the number of estates required to file Form 706 will continue declining as the exemption reaches the high point under EGTRRA in 2009. In 2010, when the filing requirement for the previous calendar year will have increased to \$3.5 million, the total number of federal estate tax returns (some with tax due, and some not) projected to be filed will have fallen to approximately 17,500.

If the pattern continues, under which about 45 percent of the total number of federal estate tax returns filed nationwide show a tax due, less than 8,000 taxable estate tax returns will be filed in 2010—a drop of approximately 85 percent over a nine-year period.



IRS Manpower:

Of course, unless the IRS cuts the amount of agents drastically (and this is not expected at this point) the reduced number of returns will be reviewed and contested by more auditors.

In 2001, when 108,071 federal estate tax returns were filed nationwide, there were about 350 attorneys in the IRS Estate and Gift Tax Program auditing federal estate tax returns nationwide. With a staff of about 350 auditors, there were slightly more than 300 federal estate tax returns filed for every auditor in 2001. IRS estate tax attorneys are informally expected to close about 30 examined estate tax cases annually with some degree of substantive adjustment. Consequently, about 10 percent of all (taxable, and non taxable) federal estate tax returns were being thoroughly audited by the IRS in 2001. By 2005, when the total number of federal estate tax returns had dropped to 45,070, there were only about 129 returns being filed for every auditor. The estate tax audit rate had jumped to 24 percent. These audit rates are dramatically higher than the 1 percent to 2 percent audit rate for individual income tax returns.

Of course, the increased audit coverage rate for taxable estate tax returns has been even more dramatic. In 2001, it was 20 percent, because 51,736 taxable estate tax returns were filed nationwide and there were about 150 taxable estate tax returns filed for every auditor. By 2005, the audit rate for taxable estate tax returns was over 50 percent, because there were only 20,250 taxable estate tax returns filed nationwide and therefore about 58 taxable estate tax returns filed for each auditor. This increased audit rate led to a reorganization within the IRS under which the total number of estate tax auditors was reduced from 350 down to 270 (a workforce reduction of about 23 percent). This staff reduction caused a brief uptick in the number of taxable estate tax returns per auditor in 2006. But the number of taxable returns per auditor dropped again when the exemption recently increased from \$1.5 million to \$2 million for 2006 through 2008.

In 2007, the first year after the exemption was increased to \$2 million, there were 38,031 federal estate tax returns filed nationwide. With 270 IRS auditors, the audit rate would have risen back to about 20 percent and the audit rate for the 17,416 taxable returns filed in 2007 would have risen to close to 50 percent. In 2010, the year after the federal estate tax exemption will have risen to \$3.5 million, the IRS has projected that 17,500 federal estate tax returns will be filed nationwide. If there are still 270 auditors, the audit rate for all federal estate tax returns will have increased to almost 50 percent, and the audit rate for taxable returns will be virtually 100 percent.

