THE NATION'S TRANSFER TAX REGIME AND THE TAX GAP

JAY A. SOLED[*]

For over a century, the nation's transfer tax regime, comprised of the gift, estate, and generation-skipping transfer taxes, has played a pivotal role in curbing inherited wealth while simultaneously raising much-needed revenue. But for a variety of reasons, a sizable number of taxpayers are derelict in fulfilling their transfer tax obligations. This analysis explores the reasons for this phenomenon and the reforms that Congress should consider instituting to curb this behavior.

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I. Introduction

Politicians routinely talk about closing the nation's tax gap—defined as the difference between what taxpayers actually pay in taxes in a timely

* Jay A. Soled is a Distinguished Professor of Taxation at Rutgers Business School.

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manner and what they would pay if they fully complied with the tax laws[1]—as a pain-free way to raise revenue without increasing taxes.[2] Historically, the focus of these politicians has been on the nation's income tax—and rightfully so because this is where the greatest amount of lost revenue is at stake.[3] Indeed, with a voluntary compliance rate that hovers in the 80% range,[4] the most recently available data indicates that close to a half-trillion dollars of income tax revenue remains uncollected.[5] By contrast, when it comes to the nation's transfer regime (comprised of the gift, estate, and generation-skipping transfer taxes), the estimated tax gap is relatively trivial in size—a mere $1.3 billion annually.[6]

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1. *See generally* Robert E. Brown & Mark J. Mazur, *IRS's Comprehensive Approach to Compliance Measurement*, 56 NAT'L TAX J. 689 (2003); Mark J. Mazur & Alan H. Plumley, *Understanding the Tax Gap*, 60 NAT'L TAX J. 569 (2007); Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 STAN. L. POL'Y REV. 7 (2009); Eric Toder, *What Is the Tax Gap?*, 117 TAX NOTES 367 (2007).

2. *See* Eric Toder, *Reducing the Tax Gap: The Illusion of Pain-Free Deficit Reduction*, URB. INST. 1 (July 3, 2007), https://perma.cc/C5X6-JYEJ ("[P]oliticians and some economists see measures to close the tax gap as a key component of a deficit reduction strategy.").

3. MELANIE R. KRAUSE ET AL., INTERNAL REVENUE SERV., PUB. NO. 1415, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2014–2016, at 1 (Oct. 2022), https://www.irs.gov/pub/irs-pdf/p1415.pdf ("The individual income tax makes up the largest component of the tax gap, contributing $357 billion to the gross tax gap and $306 to the net tax gap. The second and third largest components involve employment tax, which includes self-employment, FICA and FUTA tax, and corporation income tax.").

4. *Id.* ("The Net Compliance Rate (NCR) is defined as the sum of 'tax paid voluntarily and timely' and 'enforced and other late payments' divided by 'total true tax', expressed as a percentage. The estimated NCR is 87.0 percent.").

5. *Id.* ("The gross tax gap is the amount of true tax liability that is not paid voluntarily and timely. The estimated annual gross tax gap for Tax Years (TY) 2014–2016 is $496 billion.").

6. *Id.* at 24. This dollar amount, namely, $1.3 billion, constitutes approximately 5% of the overall revenue, namely, $18.3 billion, which was collected via the estate tax in 2016. *Statistics of Income Tax Stats—Estate Tax Filing Year Tables*, INTERNAL REVENUE SERV., https://www.irs.gov/statistics/soi-tax-stats-estate-tax-filing-year-tables (last updated May 30, 2023). Admittedly, the report refers only to broad underreporting tax gap categories such as the "Individual Income Tax," "Corporate Income Tax," "Employment Tax," and the "Estate Tax." *See id.* at 11, tbl.2. In doing so, the report specifically fails to mention either the gift or generation-skipping transfer tax. One of two suppositions thus seems appropriate: either the dollar amounts comprising the gift and generation-skipping transfer taxes are too small to be worthy of mention, or, alternatively, the "Estate Tax" category is broad enough to encompass both the gift and generation-skipping transfer taxes.

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Tomes of academic literature have been written about ways to close the nation's income tax gap.[7] Recommended and instituted measures have included enhancing Internal Revenue Service ("IRS") funding, expanding the issuance of third-party information returns, strengthening the penalty regime of the Internal Revenue Code ("Code"), and reconfiguring tax return forms.[8] Doubtless, adopting many of the foregoing methods has helped to check taxpayers' tax derelictions, albeit compliance challenges remain.[9]

By contrast, little has been written about the tax gap involving the nation's transfer tax regime and the ways that Congress and the IRS might choose to close it. There are several reasons for this absence, including not only that the financial stakes appear much smaller but also, as demonstrated over the last several decades, that Congress seems to have little political appetite for bolstering the nation's transfer tax regime, which many politicians commonly and pejoratively refer to as the *death tax*.[10]

But the nation's transfer tax regime and the tax gap are at the precipice of becoming major concerns. The reasons are threefold: first, as a whole, the demographics of the nation are quickly becoming increasingly older;[11]

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7. *See generally, e.g.*, Susan Cleary Morse, *Using Salience and Influence to Narrow the Tax Gap*, 40 LOY. U. CHI. L.J. 483 (2009) ("This Article argues that more salient government communications and greater attention to principles of influence would improve existing and proposed policies to encourage self-employed and small business taxpayers to pay their taxes."); Richard B. Malamud & Richard O. Parry, *It's Time to Do Something About the Tax Gap*, 9 HOUS. BUS. & TAX L.J. 1 (2008); OFF. OF TAX POL'Y, U.S. DEP'T OF TREASURY, A COMPREHENSIVE STRATEGY FOR REDUCING THE TAX GAP (2006), https://www.irs.gov/pub/irs-news/comprehensive_strategy.pdf; U.S. GOV'T ACCOUNTABILITY OFF., GAO-06-208T, TAX GAP: MULTIPLE STRATEGIES, BETTER COMPLIANCE DATA, AND LONG-TERM GOALS ARE NEEDED TO IMPROVE TAXPAYER COMPLIANCE (2005), https://www.gao.gov/assets/gao-06-208t-highlights.pdf.

8. *See* Olson, *supra* note 1, at 13, 19, 33. Regarding the need to improve how tax returns themselves are constructed, see James Alm et al., *Multibillion Dollar Tax Questions*, 84 OHIO ST. L.J. (forthcoming 2023); Joseph Bankman et al., *Using the "Smart Return" to Reduce Evasion and Simplify Tax Filing*, 69 TAX L. REV. 459, 459–60 (2016).

9. Bankman et al., *supra* note 8, at 459.

10. *See* MICHAEL GRAETZ & IAN SHAPIRO, DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH 85–98 (2005) (tracing how right-wing think tanks coined the phrase *death tax* to label the estate tax).

11. *See* Jonathan Vespa, *The Graying of America: More Older Adults Than Kids by 2035*, U.S CENSUS BUREAU (Oct. 8, 2019), https://www.census.gov/library/stories/2018/03/graying-america.html (explaining how the U.S. population is trending older).

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second, wealth has become further concentrated in the hands of the upper economic echelons;[12] and third, the nation's deficit is looming ever larger.[13]

This analysis explores the tax gap and its relationship to the nation's transfer tax regime. Part II overviews the transfer tax regime, distinguishes between legitimate techniques that reduce a taxpayer's transfer tax burden and do not count in the tax gap figures from illegitimate techniques that do count, and seeks to quantify the magnitude of the problem. Next, Part III details the nature of the problem and why the transfer tax regime is particularly vulnerable to taxpayer noncompliance. Part IV then posits reform measures that Congress and the IRS should institute to augment taxpayer compliance and thereby help close the tax gap insofar as it pertains to the transfer tax regime. Finally, Part V concludes.

II. Background

Investigations into the size and scope of the nation's tax gap are not new phenomena. For decades, the IRS has conducted such studies—and for good reason: they result in the development of salient guideposts. These guideposts indicate where the agency should devote its limited enforcement resources, and they identify possible legislative measures that Congress should institute to promote taxpayer compliance.[14]

At the outset, one point must be made abundantly clear: tax gap studies are not easy to conduct and are often resource intensive. When it comes to tax filers, for example, the IRS must conduct detailed audits to ascertain exactly where taxpayers are falling short of the compliance mark.[15] Similarly, when it comes to taxpayers who fail to file, the IRS must make

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12. *See* NADIA KARAMCHEVA ET AL., CONG. BUDGET OFF., TRENDS IN THE DISTRIBUTION OF FAMILY WEALTH, 1989 TO 2019, at 1 (2022), https://www.cbo.gov/publication/58533#_idTextAnchor001 ("The share of total wealth held by families in the top 10 percent of the distribution increased from 63 percent in 1989 to 72 percent in 2019, and the share of total wealth held by families in the top 1 percent of the distribution increased from 27 percent to 34 percent over the same period, CBO estimates.").

13. *See* Kimberly Amadeo, *US Budget Deficit by Year Compared to GDP, the National Debt, and Events*, BALANCE (Apr. 5, 2022), https://www.thebalancemoney.com/us-deficit-by-year-3306306 (describing how the U.S. deficit is becoming increasingly problematic).

14. *See* Robert E. Brown & Mark J. Mazur, *The National Research Program: Measuring Taxpayer Compliance Comprehensively*, 51 U. KAN. L. REV. 1255, 1255 (2003) ("Measuring taxpayer compliance for the Internal Revenue Service (IRS) is analogous to measuring the net profit for a private sector business. Both are summary, bottom-line measures of the effectiveness of the organization.").

15. *See id*. at 1264–69 (describing the National Research Program, which enables the IRS to gather large amounts of data in order to make taxpayer-compliance determinations).

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challenging estimates of the number of nonfilers and the amount of revenue being lost.[16]

Notwithstanding the difficulties associated with making tax gap determinations, these determinations function as lodestars for IRS enforcement resource-allocation efforts and, furthermore, serve as metrics for Congress to both determine agency efficiency and gauge appropriate funding—all in an endeavor to augment taxpayer compliance.[17]

To state the obvious, taxpayer compliance is critical for three reasons. First, it raises revenue to meet the nation's ever-growing public expenditure needs.[18] Second, the very act of making a tax payment can fuel patriotic pride, as taxpayers may think that they have a stake in the overall nation-state enterprise.[19] Finally, there is a messaging issue: it would set a terrible precedent if taxpayers were granted tacit license to break certain laws.[20]

The three sections below provide important background information to help understand the underlying nature of the growing tax gap in the transfer tax realm. Section A overviews the nation's transfer tax system; Section B distinguishes between legitimate transfer tax–reduction techniques not included in the tax gap and illegitimate transfer tax–reduction techniques that are included; and, finally, Section C provides a numerical overview of

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16. *See id.* at 1259 ("To estimate the Filing Rate for the individual income tax, the IRS used the publicly available Consumer Population Survey to estimate the number of individuals who had a filing obligation in a given year (that is, those who appeared to have enough income to be subject to the income tax) and compared this number with the number of tax returns that were filed." (internal citation omitted)).

17. *See* U.S. GEN. ACCT. OFF., GAO-02-769, TAX ADMINISTRATION: NEW COMPLIANCE RESEARCH EFFORT IS ON TRACK, BUT IMPORTANT WORK REMAINS 19 (2002), https://www.gao.gov/assets/gao-02-769.pdf ("IRS needs accurate and up-to-date information on taxpayers' compliance with the tax laws in order to help it understand the effectiveness of its programs to promote and enforce compliance and target its enforcement audits on noncompliant returns.").

18. *See, e.g.*, Michael C. Durst, *Report of the Second Invitational Conference on Income Tax Compliance*, 42 TAX LAW. 705, 712 (1989) ("[T]ax compliance . . . generate[s] additional net revenue."); *see also id.* at 712 n.6 (explaining that tax compliance expenditures bring in 3.1 times as much revenue).

19. *See* J. Timothy Philipps, *It's Not Easy Being Easy: Advising Tax Return Positions*, 50 WASH. & LEE L. REV. 589, 629 (1993) ("To be sure, some pay because of a sense of duty and civic pride.").

20. *See, e.g.*, RICHARD SCHMALBECK & LAWRENCE ZELENAK, FEDERAL INCOME TAXATION 52 (3d ed. 2011) ("[T]he existence of unenforced rules may foster a general disrespect for the tax system, and thus encourage cheating not only with respect to tips but whenever cheating is not likely to be detected.").

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the severity of the tax gap problem insofar as the nation's transfer tax system is concerned.

A. The Nation's Transfer Tax Regime: A Summary View

In 1916, the country's transfer tax system sprung into existence when Congress enacted the estate tax.[21] Since then, Congress added the gift tax in 1924[22] and the generation-skipping transfer (GST) tax in 1986.[23] Together, these three taxes constitute the bulwark of the nation's transfer tax regime. Consider the functionality of each tax.

The nation's estate tax was designed to have a dual purpose. First, Congress instituted the estate tax to curtail inherited wealth; the rationale then was that too much wealth concentrated in the hands of a few would cascade down the generations and produce a dynastic political environment that was antithetical to the ethos of the United States.[24] Second, Congress enacted the estate tax to raise revenue to meet pressing public expenditure needs at home and to help fund European armaments during World War I.[25]

The estate tax, applicable upon a taxpayer's passing and levied upon the taxpayer's wealth, functions in a relatively straightforward manner. In a nutshell, its base is comprised of the fair market value of those assets held in the decedent's name (e.g., bank accounts)[26] and those assets not in the decedent's name but over which the decedent had indicia of control (e.g.,

21. Revenue Act of 1916, Pub. L. No. 64-271, §§ 200–212, 39 Stat. 756, 777–80 (codified as amended in scattered sections of 26 U.S.C.).

22. Revenue Act of 1924, Pub. L. No. 68-176, §§ 319–324, 43 Stat. 253, 313–16 (previously codified at I.R.C. §§ 1131–1136 (West 1928)). This tax was repealed in 1926. Revenue Act of 1926, Pub. L. No. 69-20, § 1200, 44 Stat. 9, 125–26 (repealing I.R.C. §§ 1131–1136 (West 1928)). However, it was later reenacted in 1932. Gift Tax Act of 1932, ch. 209, § 532, 47 Stat. 169, 245–59 (previously codified at I.R.C. §§ 550–580 (1934)). The current version of the gift tax was enacted in 1954 and is codified as amended at I.R.C. §§ 2501–2524.

23. Tax Reform Act of 1976, Pub. L. No. 94-455, §§ 2001–2009, 90 Stat. 1520, 1846–1905. In 1986, Congress retroactively repealed the law but supplemented it with a new taxing regime. Tax Reform Act of 1986, Pub. L. No. 99-514, §§ 1431–1433, 100 Stat. 2085, 2717–32.

24. *See* David Hasen, *Accretion-Based Progressive Wealth Taxation*, 20 FLA. TAX REV. 277, 302 (2017) ("[O]ne of Congress's principal purposes in enacting the estate tax was to curb dynastic wealth.").

25. *See* Samuel D. Brunson, *Afterlife of the Death Tax*, 94 IND. L.J. 355, 357 (2019) ("[T]he principal purpose motivating Congress to enact the estate tax was a need for revenue.").

26. *See* I.R.C. § 2033.

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title to assets held in a revocable trust).[27] The Code then allows certain deductions (e.g., unlimited charitable and marital deductions) in order to arrive at the net taxable estate.[28] However, to protect the general populace from this tax, the decedent's basic lifetime exclusion (currently, $13,610,000) is then subtracted from the net taxable estate,[29] eliminating the vast majority of decedents' estates from taxability.[30] The remaining dollar amount, if any, is then multiplied by a flat tax rate (currently, 40%) to arrive at the estate tax due.[31]

In 1924, to prevent circumvention of the estate tax base, Congress enacted the gift tax.[32] Prior to instituting this tax, a common estate tax–avoidance practice was for taxpayers to transfer title to their assets to their loved ones during the taxpayers' lifetime.[33] The gift tax largely ended this practice. Going forward, taxpayers who made gifts that exceeded certain dollar thresholds (the threshold dollar amounts of which have varied from year to year) would either pay an immediate gift tax or use all or part of their basic estate tax exemption amount.[34]

The gift tax functions much like its estate tax counterpart. The gift tax base is comprised of the fair market value of all the assets—tangible and intangible—to which a taxpayer gratuitously transfers title to another

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27. *Id.* §§ 2036–2038.

28. *Id.* §§ 2055–2056.

29. *Id.* § 2010(c)(3); *see also* Rev. Proc. 2023-34, 2023-48 I.R.B. 1287, § 3.41 ("Unified Credit Against Estate Tax. For an estate of any decedent dying in calendar year 2024, the basic exclusion amount is $13,610,000 for determining the amount of the unified credit against estate tax under § 2010.").

30. *See* Darien B. Jacobson et al., *The Estate Tax: Ninety Years and Counting*, 27 STAT. INCOME BULL. 118, 125 (2007) (the percentage of taxpayers subject to estate tax hovers in the 2 percent range).

31. I.R.C. § 2001(c).

32. *See supra* note 22.

33. *See* William C. Warren, *Correlation of Gift and Estate Taxes*, 55 HARV. L. REV. 1, 2 (1941).

> Immediately upon the enactment of the estate tax in 1916, efforts to avoid the tax were made, and they became more prevalent as the rates were increased. As the loopholes were found, Congress, in each revenue act, tried to close them. The easiest means of avoidance was the transfer of a considerable portion of an estate by inter vivos gifts shortly before death. If effective transfers were made early, both income and estate taxes were avoided. The impossibility of coping successfully with the many methods and devices employed to avoid the estate tax and also the income tax resulted in the introduction of a tax on gifts in the federal revenue system by the Revenue Act of 1924.

Id.

34. *See* I.R.C. § 2501.

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person.[35] Against this dollar amount, certain deductions are permitted akin to those of the estate tax (e.g., the unlimited charitable and marital deductions).[36] Coupled with those deductions are special exclusions for relatively small lifetime gifts (currently, the annual exclusion is $17,000) and for payments made on another's behalf, like to educational institutions or for medical care.[37] After accounting for these deductions and exclusions, the remaining dollar amount is then reduced by the taxpayer's unused basic lifetime exclusion amount (currently, $13,610,000),[38] and the result is then multiplied by the governing gift tax rate (currently, 40%) to determine the actual gift tax due.[39]

In addition to the gift tax, Congress decided that the nation's transfer tax regime needed a second layer of protection from taxpayer circumvention.[40] Hence, in 1976 Congress introduced the so-called GST tax, but, due to its original complexity, Congress repealed and replaced it in 1986.[41] This prophylactic measure was designed to address those situations in which taxpayers, in an endeavor to minimize or eliminate the future transfer tax exposure of their children (who are deemed *non-skip* persons under the

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35. *See id.* § 2511.

36. *See id.* §§ 2522–2523.

37. *Id.* § 2503(b), (e); *see also Estate Tax: Filing Threshold for Year of Death*, INTERNAL REV. SERV., https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax (last updated Nov. 27, 2023).

38. I.R.C. § 2505(a).

39. *Id.* § 2502(a)(1). This Code section references I.R.C. § 2001(c), which essentially sets the transfer tax rate at 40% for those transfers that exceed the basic exclusion amount under I.R.C. § 2010(c) (currently, $13,610,000).

40. *See* Jacobson et al., *supra* note 30, at 123.

> The 1976 tax reform package also introduced a tax on generation-skipping transfer trusts (GSTs). Prior to passage of the act, a transferor, for example, could create a testamentary trust and direct that the income from the trust be paid to his or her children during their lives and then, upon the children's deaths, that the principal be paid to the transferor's grandchildren. The trust assets included in the transferor's estate would be taxed upon the transferor's death. Then, any trust assets included in the grandchildren's estates would be taxed at their deaths. However, the intervening beneficiaries, the transferor's children in this example, would pay no estate tax on the trust assets, even though they had enjoyed the income derived from those assets. Congress responded to the GST tax leakage by creating a series of rules that were designed to treat the termination of the intervening beneficiaries' interests as a taxable event.

Id.

41. In 1986, Congress retroactively repealed the 1976 version of the GST tax and instituted an extensively revised tax. Tax Reform Act of 1986, Pub. L. No. 99-514, §§ 1431–1433, 100 Stat. 2085, 2717 (enacting a tax on "Generation-Skipping Transfers").

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Code),[42] bypassed them and instead transferred title to their assets to so-called *skip persons* (primarily, their grandchildren and great-grandchildren).[43] By going through this machination, taxpayers could potentially defer estate tax application on their wealth for one or more generations. By instituting the GST tax, Congress hoped to eliminate the foregoing strategy.[44] Going forward, transfers to skip persons during life or upon death would not only produce a gift or estate tax but also trigger a possible GST tax as well, with the overarching goal of imposing a transfer tax once at every generational level.

The GST tax functions differently than the estate and gift taxes. For starters, there are three events that trigger GST tax application: (i) direct skips (when a transfer is made directly to a skip person), (ii) taxable distributions (when a transfer is made from a trust to a skip person), and (iii) taxable terminations (when a trust terminates and the trust property vests with one or more skip persons).[45] Essentially, the tax base is the fair market value of the assets that a skip person receives.[46] Congress wanted the GST tax, just like the estate and gift taxes, to apply only to a narrow segment of taxpayers and therefore provided a generous lifetime exemption (currently, $13,610,000).[47] Applying this exemption to the fair market value of the property being transferred to skip persons could potentially reduce the GST tax rate to zero (when, in the vernacular of estate planners, the so-called inclusion rate is zero); alternatively, if no exemption amount is allocated and hence the inclusion rate is one, the governing GST tax rate (currently, 40%) would apply.[48]

Over several decades, the vibrancy of the nation's transfer tax regime has ebbed and flowed. In some years, it has produced robust revenue on the nation's behalf; other years, only moderate amounts; and most recently, somewhat anemic amounts.[49] The number of transfer tax returns reporting

42. *See* I.R.C. § 2613(b) (categorizing children as "non-skip person[s]").

43. *Id.* § 2613(a).

44. *See* Jacobson et al., *supra* note 30, at 123.

45. I.R.C. § 2612(a)–(c).

46. *Id.* §§ 2621–2623.

47. *Id.* § 2631(c).

48. *Id.* §§ 2641–2642. Code § 2641 references I.R.C. § 2001, which sets the maximum transfer tax rate—the tax rate applicable to generation-skipping transfers—at 40%.

49. *See* SHANNON MOK & JAMES WILLIAMSON, CONG. BUDGET OFF., UNDERSTANDING FEDERAL ESTATE AND GIFT TAXES 1 (June 2021), https://www.cbo.gov/system/files/2021-

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taxable amounts reflects the fact that the impact of the nation's transfer tax regime has dwindled. By way of example, nationwide in 2021, the IRS reported 2,584 taxable estates[50] and a measly 516 gift tax returns.[51]

While the nation's transfer tax regime has lost a bit of its bite, it has not completely lost its sting.[52] For example, suppose a widow dies with a $100 million estate and is survived by her five children. Assuming that she has already exhausted her basic exclusion amount, the federal estate bill would equal $40 million ($100,000,000 x .4), leaving only $60 million for her descendants. Many academics, politicians, and commentators might reason that the resulting $60 million is not anything to complain about; however, prior to death, the widow and her children might not share this lighthearted view, particularly the latter, who may think that their respective lifestyles demand more robust funding. Thus, the widow and her children may choose to employ transfer tax–reduction techniques. And that is exactly when concerns regarding the transfer tax regime and, more specifically, the tax gap are likely to come into play.

B. Legitimate Versus Illegitimate Tax-Reduction Techniques

When the IRS makes tax gap estimates, the agency must carefully distinguish between those tax-minimization techniques that are legitimate versus those that are illegitimate. Only those actions that are illegitimate and result in lost revenue are incorporated into the tax gap figures.[53] To further illustrate this distinction, consider two comparisons, the first in the income tax realm and the second in the transfer tax realm.

Comparison #1: Income Tax Avoidance Versus Evasion: In the income tax realm, taxpayers are notorious for capitalizing on various tax-avoidance

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06/57129-Estate-and-Gift-Tax.pdf (describing how, in 2020, the total estate tax collected was approximately $17 billion and the total gift tax revenue was $1 billion).

50. *Statistics of Income Tax Stats—Estate Tax Filing Year Tables*, *supra* note 6.

51. *SOI Tax Stats—Gift Tax Statistics*, INTERNAL REVENUE SERV., https://www.irs.gov/statistics/soi-tax-stats-gift-tax-statistics (last updated July 27, 2023).

52. *See* Paul L. Caron & James R. Repetti, *The Estate Tax Non-Gap: Why Repeal a "Voluntary" Tax?*, 20 STAN. L. & POL'Y REV. 153, 169 (2009) ("[T]he estate tax imposes a significant burden on even the largest estates.").

53. *See, e.g.*, Offiong Ekah, Comment, *The Tax Gap: Do Billions in Uncollected Income Taxes Speed Up Economic Downturn During a Global Pandemic?*, 42 J. NAT'L ASS'N ADMIN. L. JUDICIARY 82, 87–88 (2021) ("[T]ax evasion . . . is comprised of 'illegal and intentional actions taken by taxpayers to circumvent their legally due tax obligations.' This illegal activity includes overstating deductions or credits, and '[i]t is the existence of tax evasion, not tax avoidance, that creates what commentators term the "tax gap."'" (quoting James Alm & Jay A. Soled, *W(h)ither the Tax Gap?*, 92 WASH. L. REV. 521, 524–25 (2017))).

techniques. Some of these techniques are quite simple in nature; for example, a taxpayer may choose to hold onto an equity interest in stock for more than one year (the current holding period for a gain/loss to be considered long-term) in order to command a lower long-term capital gains tax rate.[54] Others are far more complex; for example, as part of a tax-free dividend, a corporate taxpayer issues preferred shares to its shareholders, who thereafter sell such shares to an accommodation party, commanding capital gains rates on the sale, and then the corporate taxpayer redeems such shares from the accommodation party.[55] Whatever the case, tax-avoidance maneuvers that result in tax savings are not incorporated into the tax gap figures.

But the tax gap implications radically change when taxpayers purposefully seek to evade their tax obligations. Like tax-avoidance techniques, tax evasion can range from the simple (e.g., holding offshore accounts with unreported income)[56] to the highly complex (e.g., making investments in tax shelter products that are specifically designed to manufacture artificial losses).[57] Notwithstanding the methodology that taxpayers employ, however, the tax revenue that the government forfeits from these ploys increases the tax gap's size.

Comparison #2: Transfer Tax Avoidance Versus Evasion: When it comes to the transfer tax regime and the tax gap, there are many parallels with the income tax. Consider that there are those transfer tax–saving mechanisms that the Code sanctions. Such techniques include, but are not limited to, making annual exclusion gifts,[58] establishing grantor-retained annuity trusts,[59] and making gifts of closely held equity interests in

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54. *See* I.R.C. § 1(h).

55. *See generally* Chamberlin v. Comm'r, 207 F.2d 462 (6th Cir. 1953).

56. *See* U.S. SENATE PERMANENT SUBCOMM. ON INVESTIGATIONS, 113TH CONG., OFFSHORE TAX EVASION: THE EFFORT TO COLLECT UNPAID TAXES ON BILLIONS IN HIDDEN OFFSHORE ACCOUNTS 64 (2014), https://www.hsgac.senate.gov/subcommittees/investigations/library/files/report-offshore-tax-evasion-the-effort-to-collect-unpaid-taxes-on-billions-in-hidden-offshore-accounts-5-14-14-update (describing the massive amounts of annual revenue that the United States loses as a result of unreported offshore accounts).

57. *See generally* Karen C. Burke & Grayson M. P. McCouch, *COBRA Strikes Back: Anatomy of a Tax Shelter*, 62 TAX LAW. 59 (2008) (explaining how various tax shelters are designed to manufacture losses).

58. *See, e.g.*, Robert B. Smith, *Should We Give Away the Annual Exclusion?*, 1 FLA. TAX REV. 361, 401–07 (1993) (setting out how taxpayers abuse this exclusion).

59. *See, e.g.*, Steven J. Arsenault, *Grantor Retained Annuity Trusts: After $100 Billion, It's Time to Solve the Great GRAT Caper*, 63 DRAKE L. REV. 373, 373 (2015) (delineating how grantor-retained annuity trusts readily enable taxpayers to circumvent their transfer tax obligations).

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corporations and partnerships that command marketability and minority interest valuation discounts.[60]

Yet there are those methods that taxpayers employ to save or eliminate their transfer tax exposure that the Code does not sanction. Such methods include, but are not limited to, making large, unreported gifts to loved ones or failing to report valuable jewelry owned by the decedent on the date of death. It is methods like these that result in the burgeoning of the tax gap in the transfer tax realm.

C. The Transfer Tax System and the Tax Gap's Magnitude

At least three academic studies have examined the tax gap's magnitude insofar as the estate tax is concerned. Their conclusions vary. In chronological order of the study conducted, the chart below summarizes their respective outcomes.

Study Authors	*Year*	*Voluntary Compliance Rate*
Edward N. Wolff[61]	1993	23.4%
James Poterba[62]	1997	Greater than 90%
Martha Britton Eller, Brian Erar & Chih-Chin Ho[63]	2001	Less than 87%

Beyond these academic studies that focused upon the estate tax, the Treasury Department routinely conducts its own tax gap studies, which are regularly reported and publicized. These studies report the tax gap's size

60. *See, e.g.*, James R. Repetti, *Minority Discounts: The Alchemy in Estate and Gift Taxation*, 50 TAX L. REV. 415, 421 (1995) (chronicling how taxpayers manipulate property ownership to capitalize upon minority and marketability discounts).

61. Edward N. Wolff, Commentary, *The Uneasy Case for Abolishing the Estate Tax*, 51 TAX L. REV. 517, 521 (1996) ("Perhaps, the most striking result is that whereas actual estate tax collections in 1993 were $10.3 billion, my simulations indicate that it should have been $44 billion, more than a fourfold difference!").

62. James Poterba, *The Estate Tax and After-Tax Investment Returns* 17 (Nat'l Bureau of Econ. Rsch., Working Paper No. 6337, 1997), https://www.nber.org/papers/w6337 (estimating estate tax collections of $15.7 billion whereas actual taxes collected proved to be $14.3 billion).

63. Martha Britton Eller et al., *Noncompliance with the Federal Estate Tax*, *in* RETHINKING ESTATE AND GIFT TAXATION 375, 385 (William G. Gale et al. eds., 2001) (reporting that, based on their study, a 13% estate tax gap "likely understates the true tax gap").

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for a variety of different taxes (e.g., income, corporate, and employment taxes) and include the estate tax.

The chart below, which pertains specifically to the estate tax, considers three more recent studies and the purported voluntary compliance rate.

Year	*Voluntary Compliance Rate*
2014–2016[64]	79%
2011–2013[65]	82%
2008–2010[66]	80%

There are many possible reasons for the wide percentage variations posited in the foregoing tax gap studies. The first and foremost reason is that putting an exact figure on how much wealth passes annually from decedents to their family members is difficult. Academics have sought to achieve this objective indirectly by utilizing data found in the Survey of Consumer Finance,[67] but other scholars have questioned the efficacy of doing so;[68] furthermore, the Treasury Department itself acknowledges the difficulties of conducting tax gap studies.[69] Another issue that neither the

64. KRAUSE ET AL., *supra* note 3, at 13 tbl.3.

65. INTERNAL REVENUE SERV., PUB. 1415, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2011–2013, at 13 tbl.3 (2019), https://www.irs.gov/pub/irs-prior/p1415--2019.pdf. However, these findings were subsequently revised in a later report. INTERNAL REVENUE SERV., PUB. 1415, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2014–2016, at 13 tbl.3 (2022), https://www.irs.gov/pub/irs-pdf/p1415.pdf.

66. INTERNAL REVENUE SERV., PUB. 1415, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2008–2010, at 10 tbl.3 (2015), https://www.irs.gov/pub/irs-soi/p1415.pdf. However, these findings were subsequently revised in a later report. INTERNAL REVENUE SERV., PUB. 1415, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2011–2013, at 13 tbl.3 (2019), https://www.irs.gov/pub/irs-prior/p1415--2019.pdf.

67. *See* Wolff, *supra* note 61, at 519; Poterba, *supra* note 62, at 14.

68. *See* Eller et al., *supra* note 63, at 380–82 ("[W]hile Poterba's methodology tends to understate the estate tax bill for married decedents, Wolff's methodology tends to substantially overstate it.").

69. *See* KRAUSE ET AL., *supra* note 3, at 4. The report argues:

> Estimating the tax gap is inherently challenging and, given the complexity of the tax system and available data, no single approach can be used for estimating each component. Each approach is subject to nonsampling error; the component estimates that are based on samples are further subject to sampling error. The

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academic community nor the Treasury Department apparently considers is how much of the estate tax gap may be a by-product of taxpayer noncompliance in gift tax reporting practices.[70]

Notwithstanding these wide variations, with one exception,[71] the tax gap percentages appear universally high.[72] There is also ample anecdotal evidence that depicts the severity of the problem. Several years ago, for example, the IRS studied public real estate records and discovered that 60% to 90% of taxpayers who transferred title to real estate to a relative failed to file a gift tax return.[73] Furthermore, a series of IRS gift tax audits revealed that "[m]ore than 80 percent of the 1,651 tax returns reporting gifts of $1 million or more . . . understated the value of the gift. . . . The average understatement was about $303,000 on which about $167,000 in additional gift taxes was due."[74] Given these statistics and anecdotal evidence, it is obvious that there is a serious compliance problem in the transfer tax realm.[75]

> uncertainty of the estimates, therefore, is not readily captured by standard errors that typically accompany population estimates based on sample data.

Id.

70. None of the aforementioned reports, including those produced by the Treasury Department, specifically mentions the gift tax and its relevance to the tax gap pertaining to the estate tax.

71. *See* Poterba, *supra* note 62, at 19 ("The estimated estate tax liability [reported] corresponds quite closely to the actual estate tax liability in recent years.").

72. Two well-known and respected academics, Professors Paul Caron and James Repetti, believe that estate tax compliance does not suffer too severely from taxpayers' derelictions. Caron & Repetti, *supra* note 52, at 168. They reason that the estate tax compliance rate is likely to be high for the following two reasons: (i) due to the executor's personal liability for unpaid taxes, 31 U.S.C. § 3713(b), taxpayers are likely to be tax compliant; and (ii) estate tax returns are generally audited at a far greater rate than most other tax returns. Caron & Repetti, *supra* note 52, at 168.

73. Arden Dale, *IRS Scrutinizes Gifts of Real Estate*, WALL ST. J. (May 26, 2011, 12:01 AM), https://www.wsj.com/articles/SB10001424052702304066504576345672097256428.

74. David Cay Johnston, *I.R.S. Sees Increase in Evasion of Taxes on Gifts to Heirs*, N.Y. TIMES (Apr. 2, 2000), https://www.nytimes.com/2000/04/02/business/irs-sees-increase-in-evasion-of-taxes-on-gifts-to-heirs.html.

75. *See, e.g.*, David Barstow et al., *Trump Engaged in Suspect Tax Schemes as He Reaped Riches from His Father*, N.Y. TIMES (Oct. 2, 2018), https://www.nytimes.com/interactive/2018/10/02/us/politics/donald-trump-tax-schemes-fred-trump.html [https://perma.cc/3Y36-ZJV9] ("Much of this money came to Mr. Trump because he helped his parents dodge taxes. He and his siblings set up a sham corporation to disguise millions of dollars in gifts from their parents, records and interviews show."). Former president Trump and his family apparently are not alone in their gift-dodging games.

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The next part of this Article explores the nature of the problem and why the tax gap related to the transfer taxes may be far higher than these studies and IRS audits reveal.

III. Nature of the Problem

A question that naturally arises is why the tax gap in the transfer tax realm has metastasized and appears to be difficult to contain. The sections below enumerate and amplify the various factors that likely have contributed to the bloated size of the transfer tax gap: (A) absence of third-party tax information reporting, (B) absence of meaningful penalties, (C) detection difficulties, (D) recordkeeping difficulties, (E) complexity of the transfer tax system, and (F) taxpayers' mindsets.

A. Absence of Third-Party Tax Information Reporting

There is a plethora of studies establishing the effectiveness of third-party tax information returns.[76] Indeed, when taxpayers receive third-party tax information returns coupled with tax withholding, the voluntary compliance rate hovers around 99%; and when taxpayers receive only third-party information returns and there is no withholding, the compliance rate dips only slightly to 95%—however, when taxpayers are not issued information tax returns and there is no withholding, the compliance rate plummets to approximately 55%.[77] These studies demonstrate that the presence of third-party tax information returns plays a pivotal role in bolstering taxpayer compliance.

In the income tax realm, third-party tax information returns are ubiquitous. By way of example, when taxpayers earn a salary, they are issued a Form W-2;[78] when taxpayers earn dividends, they are issued a Form 1099-DIV;[79] when taxpayers earn interest income, they are issued a Form 1099-INT;[80] and when taxpayers sell their marketable securities and experience gains/losses, they are issued a Form 1099-B.[81] And if taxpayers

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76. *See, e.g.*, Jay A. Soled, *Homage to Information Returns*, 27 VA. TAX REV. 371, 382–83 (2007) (extolling the virtues of third-party information returns).

77. INTERNAL REVENUE SERV., PUB. 5364, TAX GAP ESTIMATES, 2014–2016 (AND PROJECTIONS FOR 2017–2019) 6 fig.1 (2022), https://www.irs.gov/pub/irs-pdf/p5364.pdf.

78. *See* I.R.C. § 6051(a).

79. *See id.* § 6042(a).

80. *See id.* § 6049(a).

81. *See id.* § 6045(g).

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fail to report the income or gains reflected on these tax information returns, they risk accuracy-related tax penalty exposure.[82]

By way of contrast, when it comes to the transfer tax realm, there is almost a complete void regarding the issuance of third-party tax information reporting requirements. The recipients of taxable gifts (gifts in excess of the gift tax annual exclusion), for example, have no obligation to issue third-party tax information returns; likewise, heirs of monetary bequests and heirs who receive property have no obligation to issue third-party tax information returns; finally, skip persons who receive monetary bequests and are recipients of property derived from gifts/bequests from loved ones two or more generations their senior have no third-party tax information issuance obligations.[83]

In the absence of third-party information tax returns, there is no reason to believe that taxpayers would be any more compliant in fulfilling their transfer tax obligations than in the income tax realm. Based on this assumption, the voluntary compliance rate among those taxpayers in the transfer tax realm likely hovers in the 50% range, strongly suggesting that the nation is potentially losing billions of dollars in annual tax revenue.

B. Absence of Meaningful Tax Penalty Regime

Many academics claim that the so-called deterrence theory explains why many taxpayers are tax compliant.[84] This theory avers that taxpayers generally weigh (i) the risks of audit exposure and the penalties of noncompliance with (ii) the potential tax savings that an illicit tax strategy might achieve—and if the former outweighs the latter, they will gravitate toward compliance, but if the latter outweighs the former, they will gravitate toward noncompliance.[85]

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82. *See, e.g.*, Estate of Stiel v. Comm'r, T.C.M. (RIA) 2009-278 (reviewing a case in which taxpayers failed to supply tax information returns to tax return preparer; that being the case, their tax return deficiency triggered the application of a tax-accuracy penalty).

83. The receipt of gifts is exempt from taxation. I.R.C. § 102(a). That being the case, from the recipient's perspective, the existence of such gifts simply disappears into the ether.

84. Kathleen DeLaney Thomas, *The Psychic Cost of Tax Evasion*, 56 B.C. L. REV. 617, 617 (2015) ("According to standard deterrence theory, policymakers should be able to reduce tax evasion by increasing tax penalties, raising the audit rate, or some combination of the two.").

85. *Id.* at 618. Thomas explains the risks as follows:

> Standard deterrence theory indicates that tax compliance can be improved by raising the expected monetary cost of evasion to taxpayers. This expected cost is a simple function of the probability of detection and the fine for evasion: If the

A numerical example illustrates this point. Suppose a taxpayer is considering whether to report an extra $100,000 that she earned as part of a one-month overseas sojourn (upon which $40,000 of income tax would be due). Suppose further that if the taxpayer fails to report the $100,000 of income, the chances of this dereliction being detected are 5% and that the concomitant penalty would be 20% on the understatement, or $8,000 (i.e., $40,000 x .2). Under these circumstances, the deterrence theory holds that a rational taxpayer would not report this income because the tax savings associated with noncompliance (i.e., $40,000) greatly outweigh the $2,400 risk of not reporting (i.e., .05 ($40,000 + $8,000)). Were the concomitant chances of detection and penalties significantly increased (say, each to 75%), the deterrence theory avers that this taxpayer would refrain from undertaking this tax-minimization strategy because the tax savings associated with noncompliance would remain at $40,000, but the risk would now be $52,500 (i.e., .75 ($40,000 + (.75 x $40,000))).

A major point of deterrence theory is that penalties and their potential application play a pivotal role in curtailing errant taxpayer behavior. The sheer ubiquity of penalty imposition attests to the faith that politicians have in deterrence theory: the vast majority of tax regimes have a meaningful system of taxpayer penalties in place to keep taxpayers' wayward proclivities in check. Some such penalties are meager (e.g., $50 per tax return for tax return preparers failing to provide their tax practitioner identification number),[86] and others are quite severe (e.g., 75% penalty on the tax understatement for civil tax fraud[87] and possible imprisonment for criminal tax fraud).[88]

But when it comes to the nation's transfer tax regime and, in particular, the gift tax (which, as already pointed out,[89] functions to protect the integrity of both the estate and GST tax bases), there is a void in meaningful tax penalties. Bear in mind that tax penalties typically come in two forms: (i) those that are administrative, applicable if taxpayers fail to file returns

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> government makes it more likely that an individual will be caught cheating or more expensive if that individual is caught, then she should be less likely to cheat. For example, a rational actor would not evade $100 of taxes if she had a fifty percent chance of incurring a $400 penalty (expected penalty of $200) or a five percent chance of incurring a $4,000 penalty (same).

Id.

86. I.R.C. § 6695(c).
87. *Id.* § 6663.
88. *Id.* § 7201.
89. *See supra* Section II.A.

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or make payments in a timely manner,[90] and (ii) others that pertain to reporting accuracy.[91] Against this backdrop, the gift tax is uniquely situated: no tax is due unless a taxpayer makes aggregate lifetime gifts that exceed the basic exclusion amount (currently, $13,610,000).[92] And because 99.9999% of the U.S. population never owes any gift tax,[93] the aforementioned administrative and accuracy-related penalties are rendered moot and wholly ineffectual because they are only assessed upon tax dollars due.

Two examples illustrate this point. First, suppose a taxpayer gifts $5 million cash to her daughter. If the taxpayer fails to file a gift tax return under such circumstances, the Code levies no failure-to-file or failure-to-pay penalty. Second, suppose this same taxpayer transfers $10 million worth of closely held business stock to her daughter and takes an aggressive 60% marketability and minority interest valuation discount, reporting a gift of only $4 million (i.e., $10 million – ($10 million x .6)). Even if the IRS were to audit the filed gift tax return and the reported value (ultimately agreed upon by both the taxpayer and the IRS) was $7 million, the $3 million of understated value (i.e., $7 million – $4 million) would result in no penalty imposition despite the fact that the initial reported value was grossly understated.[94] Doubtless, a gift tax with such deficits in enforcement mechanisms does not bode well for taxpayer compliance and simultaneously threatens the integrity of both the estate and GST tax bases.

C. Hard-to-Detect Derelictions

When it comes to improper income tax reporting, there is a host of mechanisms that detect taxpayer noncompliance. These include, but are not limited to, third-party tax information reporting if a taxpayer utilizes excessive amounts of cash to make purchases (currently, the threshold reporting amount is $10,000);[95] the ability of the IRS to scour taxpayer bank records in order to determine if a taxpayer's deposits correlate with

90. *See* I.R.C. § 6651(a) (failure to file tax return or to pay tax).

91. *See id.* § 6662(a) (imposition of accuracy-related penalty on underpayments).

92. *Id.* § 2505(a).

93. Since the number of gift tax returns in 2021 equaled 516, *see supra* note 51, and the U.S. population equaled nearly 332 million, Press Release, U.S. Census Bureau, New Vintage 2021 Population Estimates Available for the Nation, States, and Puerto Rico (Dec. 21, 2021), https://www.census.gov/newsroom/press-releases/2021/2021-population-estimates.html, the percentage of taxable returns was 516/332,000,000, or .00000155%.

94. The substantial estate or gift tax valuation penalty only applies in those instances when a transfer tax is due and owing. I.R.C. § 6662(g).

95. *Id.* § 6050I.

amounts reported on their income tax returns;[96] and, finally, the existence of whistleblower awards, which attract taxpayers to report on the errant tax practices of others.[97]

But when it comes to detecting taxpayer derelictions pertaining to gratuitous transfers, the IRS's chances of success are far more unlikely than in the income tax realm. There are three salient reasons for this phenomenon.

First, in many instances, it is easy to camouflage the receipt of gifts. For example, grandparents may take their adult children and grandchildren on expensive vacations to the Caribbean, Europe, Africa, and elsewhere; these trips technically constitute taxable gifts, yet anecdotal evidence indicates that no one is reporting such payments on their gift tax returns. Likewise, aside from educational tuition, many parents are inclined to pay for the room and board, meals, and ancillary costs of their adult children attending undergraduate and graduate programs; again, such payments theoretically constitute taxable gifts, but most parents would consider them as support obligations rather than as taxable gifts.[98] Finally, taxpayers may provide their loved ones with enriching investment and business opportunities that pass under the radar in terms of reportable gifts.[99] Together, these sorts of wealth transfers masquerade as culturally accepted, sacrosanct norms that the IRS generally does not have the fortitude or political support to challenge.

Second, there is likely to be collusive behavior between the transferor and the transferee of a gratuitous transfer. The reason for such collusion is evident: to secure future gratuitous transfers, a transferee undoubtedly wishes to remain in the transferor's good graces. As such, given the bonds between the transferor and the transferee, there is virtually no chance that

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96. *See, e.g.*, Duong v. Comm'r, 109 T.C.M. (CCH) 1476 (2015) (holding that the IRS could use the bank deposit method to determine how much income taxpayers failed to report).

97. I.R.C. § 7623(a).

98. *See* Robert G. Popovich, *Support Your Family but Leave Out Uncle Sam: A Call for Federal Gift Tax Reform*, 55 MD. L. REV. 343, 344 (1996). Consider the following:

> A son or daughter is entering college. In view of their child's accomplishments, the proud parents are devoted to furthering their child's education and, despite the high cost of such an endeavor, provide meals, housing, and other financial assistance to their child. The IRS most likely has a "winner" here—the proud parents have ostensibly made gifts that may subject them to federal gift taxes.

Id.

99. *See* Paul L. Caron, *Taxing Opportunity*, 14 VA. TAX REV. 347, 349–50 (1994). *See generally* Case Hoogendoorn, *Transfers of Opportunities—An Opportunity to Avoid Transfer Tax?*, 71 TAXES 892 (1993).

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the transferee would blow the whistle on the transferor's possible transfer tax transgressions.[100] And the facts demonstrate this point: there is not a single whistleblower court case involving a gift, estate, or GST tax matter.[101] This lack of vibrancy of the whistleblowing law dims the IRS's prospects of recruiting other taxpayers to help safeguard the integrity of the transfer tax regime.

Finally, commercial tax audits are business rather than personal in nature. In contrast, when an IRS audit involves gratuitous transfers, the exact opposite is true: everything is personal. As a practical matter, this means that auditors tend to be "gentler" in their audit inquiries (i.e., they are inclined to ask questions that are more superficial rather than piercing); and, as a result, they sometimes miss critical facts that, had they been known, would have resulted in larger revenue yields.[102]

For the foregoing reasons, the IRS's ability to detect taxpayer derelictions is limited. And taxpayers recognize this reality and capitalize on it, causing the tax gap in the transfer tax realm to further widen.

D. Inability to Maintain Accurate Records

Needless to say, accurate records play a critical role in taxpayers' ability to fulfill their civic duties. More specifically, if tax records are complete and thorough, then tax returns will more likely be complete and thorough; conversely, if tax records are incomplete and flawed, then tax returns will more likely be incomplete and flawed. Case after case bears out the veracity of this proposition.[103]

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100. Caron, *supra* note 99, at 348–49 ("Congress has not required parents to deal at arm's length with their children for federal gift tax purposes; there is no gift tax equivalent to section 482 giving the Service a roving charter to filter all dealings between parents and children through an arm's length lens.").

101. By contrast, there are numerous whistleblowing court cases involving the income tax. For excellent overviews of the whistleblowing program, see generally Karie Davis-Nozemack & Sarah Webber, *Paying the IRS Whistleblower: A Critical Analysis of Collected Proceeds*, 32 VA. TAX REV. 77 (2012); Michelle M. Kwon, *Whistling Dixie About the IRS Whistleblower Program Thanks to the IRC Confidentiality Restrictions*, 29 VA. TAX REV. 447 (2010); Dennis J. Ventry, *Whistleblowers and Qui Tam for Tax*, 61 TAX LAW. 357 (2008).

102. For an excellent overview of the estate tax audit process, see generally Richard A. Carpenter, *Obtaining the Best Results in an IRS Estate Tax Audit*, 26 EST. PLAN. 302 (1999).

103. There are literally hundreds of cases that stand for the proposition that taxpayers are poor recordkeepers. *See, e.g.*, Cheam v. Comm'r, T.C.M. (RIA) 2023-23 ("[The taxpayers] failed to provide books and records sufficient to substantiate their reported income and expenses. Because of that failure, the Commissioner computed their taxable income through a bank deposits analysis."); Nath v. Comm'r, T.C.M. (RIA) 2023-22 ("[T]he [taxpayers] failed

Notwithstanding the importance of keeping and maintaining accurate records, taxpayers are notoriously bad recordkeepers. They lose receipts[104] and they misplace files;[105] furthermore, they endure horrific events such as house fires that destroy critical tax documentation.[106] Thus, whether due to ineptitude or misfortune, preparing accurate tax returns often remains a daunting challenge.

For decades, courts have recognized these recordkeeping problems and therefore introduced the so-called Cohan rule, eponymously named after the *Cohan v. Commissioner* decision.[107] In *Cohan*, the taxpayer claimed that certain expenses that he incurred were deductible, but he failed to produce actual records to prove their legitimacy.[108] Judge Learned Hand held that courts should bear "heavily" against such estimates and that they should hold taxpayers accountable for the shortcomings associated with their own "inexactitude"—but that taxpayers nevertheless should be allowed to make approximations.[109] And ever since, except when the Code otherwise explicitly requires the production of actual records,[110] taxpayers have sought to take advantage of the magnanimity of this judicial ruling, enabling them, in the absence of records, to make good-faith estimates.[111]

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to produce books and records from which to determine their income and expenses, so the Commissioner computed their income using a bank deposits analysis. Through the bank deposits analysis, the Commissioner uncovered unreported deposits, most of which were wire transfers from Cambodia."*).* Older cases show the same pattern. *See, e.g.*, Webb v. Comm'r, 394 F.2d 366 (5th Cir. 1968) (finding taxpayer's poor recordkeeping led to the imposition of a fraud penalty); Est. of Olivo v. Comm'r, 102 T.C.M. (CCH) 35 (2011) (finding taxpayer's poor records resulted in the disallowance of a substantial deduction on a federal estate tax return for caregiving services); Westbrook v. Comm'r, 66 T.C.M. (CCH) 1823 (1993) (finding veterinarian and his wife's poor records precluded their ability to treat farming activity as a business activity).

104. *See, e.g.*, Patitz v. Comm'r, 124 T.C.M. (CCH) 216 (2022) (considering taxpayer's claim that due to a hurricane, he had lost the receipts for the business equipment he had purchased).

105. *See, e.g.*, Speck v. United States, 28 Fed. Cl. 254, 279 (1993) (considering taxpayer's apparent displacement or disposal of the relevant records).

106. *See, e.g.*, Roumi v. Comm'r, 103 T.C.M. (CCH) 1006 (2012) (considering taxpayer's argument that a fire destroyed his records).

107. Cohan v. Comm'r, 39 F.2d 540 (2d Cir. 1930).

108. *Id.* at 543–44.

109. *Id.* at 544.

110. *E.g.*, I.R.C. § 274(d).

111. *See* Jay A. Soled, *Exploring and (Re)Defining the Boundaries of the Cohan Rule*, 79 TEMP. L. REV. 939, 946 (2006) (explaining how, in certain instances, courts permit taxpayers to make estimates).

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From this background, considering taxpayer recordkeeping challenges, it is clear that accurate tax return completions are far from guaranteed. In the income tax realm, taxpayers must gather records that can date back twelve months (or, if the tax return in question is on extension, can date back eighteen months).[112] On both the internet and various social media platforms, taxpayers notoriously quibble about this record-collection exercise, complaining that they must bring the proverbial "shoebox" of important documents with them to their tax return preparers.[113] If taxpayers are subsequently audited, this record-collection exercise is even more strained: taxpayers must often produce records that stretch back three years; and if the proposed assessment is due to a substantial tax understatement, the time for record production becomes elongated to six years.[114]

As problematic as the aforementioned concerns are, they become further exacerbated in the transfer tax realm. One must keep in mind that the entirety of the transfer tax regime is based on a person's lifetime transfers.[115] Theoretically, the audit period can extend up to 122 years, or the life-span equivalent of the longest-lived human.[116] Maintaining tax records over such a period seems farcical; furthermore, this exercise in seeming futility is made worse insofar as the taxpayer herself is often not the party charged with locating these records.[117] Instead, after the taxpayer's demise, it is her executor or personal representative whose responsibility it becomes.[118]

To illustrate this point, consider a taxpayer who, in 2025, gifts $10 million to his daughter. Next, consider two different scenarios, one in which

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112. *See* Annette Nellen, *Poor Recordkeeping Hurts Taxpayers: Problems and Preventions*, TAX ADVISER (Oct. 29, 2015), https://www.thetaxadviser.com/newsletters/2015/oct/poor-tax-recordkeeping-hurts-taxpayers.html (detailing the virtues of good recordkeeping).

113. *See, e.g.*, Veronica Wasek, *Ditch the Shoebox! How QuickBooks Online Remedies Your Tax Time Blues*, 5 MINUTE BOOKKEEPING (Feb. 13, 2018), https://5minutebookkeeping.com/ditch-the-shoebox-how-quickbooks-online-remedies-your-tax-time-blues/.

114. I.R.C. § 6501(a) (providing a three-year general statute of limitations); *id.* § 6501(e) (providing a six-year statute of limitations in cases of substantial omissions).

115. *See* I.R.C. § 2010(a) (providing taxpayer's lifetime basic exclusion amount); *id.* § 2505(a)(2) (reducing taxpayer's lifetime basic exclusion amount by the amount of prior gifts made).

116. Renée Onque, *The World's Oldest Person Made It to 122—3 Reasons She Lived So Long, from a Longevity Expert Who Knew Her*, CNBC (Feb. 21, 2023, 9:06 PM), https://www.cnbc.com/2023/02/21/longevity-expert-3-reasons-the-worlds-oldest-person-lived-to-122.html.

117. I.R.C. § 6018(a).

118. *Id.*

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the taxpayer files a gift tax return and another in which the taxpayer fails to file a gift tax return. Fast-forward twenty-five years to 2050, when the taxpayer dies, and the daughter or a third-party bank is named as executor of the taxpayer's estate. In the first scenario, when preparing the decedent's estate tax return, the daughter or the bank might be uncertain about whether a gift tax return was ever filed and, if filed, its location. In the second scenario, in preparing the decedent's estate tax return, the daughter might conveniently forget ever receiving such a gift, and the bank would likely be unaware of a quarter-century-old gift.

The bottom line is simple: taxpayers' recordkeeping abilities are known to be lackluster at best and abysmal at worst.[119] In the transfer tax realm, expectations that taxpayers would exercise more due diligence than in the income tax realm are wholly misplaced.

E. Complexity

There are many reasons why taxpayers fall short of being tax compliant. Sometimes taxpayers' motivations are nefarious: in an endeavor to increase their private consumption, they purposefully report less income, artificially inflate their expenses, or simply manufacture losses out of thin air.[120] However, sometimes the reasons that taxpayers are not tax compliant are entirely innocent—they simply lack a comprehensive understanding of the law and therefore fall short of its fulfillment.[121]

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119. This inability on the taxpayer's part to produce records is commonplace. Judge Tannenwald, the former Chief Judge of the U.S. Tax Court, best summed up the situation as follows:

> This case typifies a situation with which this Court is all too frequently faced, namely, where respondent during the audit and pre-trial process perhaps overemphasizes the necessity for documentation and the taxpayer adamantly insists on the full amount of claimed deductions despite his or her inability to produce minimal substantiation. The inevitable waste of time, effort, and money is appalling. In such situations, the Court can do no more than make an estimate of what seems reasonable under the circumstances.

Dzierzawski v. Comm'r, 25 T.C.M. 820, 821 (1966), *aff'd*, 389 F.2d 1005 (6th Cir. 1968).

120. Such nefariousness is reflected in the waves of various tax shelters designed to produce artificial, noneconomic losses minimizing taxpayers' tax burdens. *See generally* Michael Hatfield, *The Rise of Law and the Fall of Circular 230: Tax Lawyer Professional Standards, 1985–2015*, 24 FLA. TAX REV. 828 (2021) (discussing the various machinations that tax shelters have taken during the course of a thirty-year period).

121. Taxpayers' reasoning for noncompliance is categorized as follows:

> [W]hen IRS auditors conducted approximately 46,000 audits of individual taxpayers, the auditors were asked to describe the reason for noncompliance for

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Unlike the annual income tax ritual, the transfer tax regime is not universally familiar to taxpayers. In fact, most taxpayers are wholly ignorant regarding its application. As a result, taxpayers' fulfillment of their gift, estate, and GST tax obligations—as elaborated below—does not rest on a firm command of their obligations.

When considering gift giving, taxpayers are notorious for failing to grasp even the most basic components of the gift tax. For example, many taxpayers mistakenly think that if they are married, insofar as the annual gift tax exclusion is concerned (currently, $17,000), they can give twice the amount of the annual gift tax exclusion (i.e., $34,000) without having to file a gift tax return;[122] others mistakenly believe that the recipient, not themselves, is responsible for filing a gift tax return and paying any gift taxes due and owing;[123] and still others believe that payments of their loved ones' debts (e.g., student loans or home mortgages) do not constitute taxable gifts but rather nonreportable support payments.[124]

For the estate tax, a major misunderstanding that some taxpayers harbor is that the portability of a decedent's lifetime exclusion amount is automatic (e.g., upon the death of a married taxpayer, the surviving spouse receives the decedent's unused lifetime exclusion amount).[125] This misunderstanding may result in the failure of some executors to file an estate tax return upon the death of the surviving spouse.[126] Another common misunderstanding regarding the estate tax is that items of personal

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> each issue they identified. Among issues that resulted in a change in tax liability, the IRS auditors listed 67% as inadvertent mistakes, 27% as computational errors or errors that flowed automatically, and only 3% of errors as intentional.

Olson, *supra* note 1, at 14.

122. *See* I.R.C. § 2513(a).

123. *See id.* § 2501(a). By contrast, when the donees obligate themselves to pay the gift tax, it is known as a "net gift." *See, e.g.*, McCord v. Comm'r, 120 T.C. 358, 368 (2003) (explaining the net gift concept in the case of taxpayers who made a large gift to their sons in return for a promise that the donees would pay the donors' gift tax resulting from the gift).

124. *Compare* Rev. Rul. 54-343, 1954-2 C.B. 318 (holding father's payment of medical and hospital bills for his adult son and living expenses to the son's family to be taxable gifts), *with* I.R.S. Gen. Couns. Mem. 38,702 (Apr. 28, 1981) ("[A] transfer to one that the transferor has a legal obligation to support is for adequate and full consideration and thus is not a taxable gift to the extent that the transfer provides reasonable support.").

125. *See* Rev. Proc. 2022-32, 2022-30 I.R.B. 101 (granting taxpayers relief in certain instances, if, after exercising due diligence, they were unaware the election was necessary).

126. *Id.*; *see also* Melony A. Sacopulos, *Revenue Procedure 2017-34 Provides Amnesty Relief for Estate and Gift Tax Exclusion Portability Elections*, RES GESTAE, Sept. 2018, at 12, 12 ("Many executors have sought relief under Code Section 9100 and the regulations thereunder.").

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property (e.g., artwork, coin collections, and the like) do not need to be reported on a decedent's estate tax return unless they are insured.[127]

Finally, with respect to the GST tax, most taxpayers (and even many tax practitioners) do not even know of its existence.[128] With the GST tax mired in obscurity, taxpayers may make sizable gifts and bequests to skip persons (often their grandchildren) with no inkling that a GST tax might be applicable or that, due to the Code's automatic allocation provisions,[129] they have exhausted all or a portion of their GST tax exemption.

Related to tax law complexity as a reason for taxpayer noncompliance, the absence of low-cost assistance resources is another contributory factor to taxpayer noncompliance. When it comes to income tax, there are a myriad of low-cost assistance resources to aid in taxpayer compliance, including tax-software packages, certified public accountants, enrolled agents, and seasoned tax-return preparers. However, in the transfer tax realm, the same is not true: good guidance often is severely limited and usually comes at the steep price tag of expensive attorneys (which some do-it-yourself taxpayers choose to bypass—and then fall short of being tax compliant).[130]

F. Taxpayers' Mindset

For the past century, taxpayers have been acculturated to pay their income taxes on an annual basis,[131] a common practice among most industrial nations.[132] The same is not true with respect to transfer taxes: taxpayers do not partake in an annual routine to file transfer tax returns, and many industrial nations do not even have such tax systems in place.[133] A

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127. Other commentators might refer to this practice as *willful ignorance*.

128. Christine Fletcher, *What Is the GST Tax?*, FORBES (Apr. 19, 2023, 9:00 AM), https://www.forbes.com/sites/christinefletcher/2022/04/19/what-is-the-gst-tax/?sh=3d7d6d5b2b76.

129. I.R.C. § 2632(b).

130. In 2023, the IRS website lists a total of 476,077 individuals with current Preparer Tax Identification Numbers; of this total, only 28,790 are listed as attorneys. *Return Preparer Office Federal Tax Return Preparer Statistics*, INTERNAL REVENUE SERV., https://www.irs.gov/tax-professionals/return-preparer-office-federal-tax-return-preparer-statistics (last updated Dec. 5, 2023).

131. *See* I.R.C. § 6011(a).

132. *See, e.g.*, Reuven S. Avi-Yonah, *The Three Goals of Taxation*, 60 TAX L. REV. 1, 5 (2006) ("In Western European countries, for example, the individual income tax accounted in 1996–2002 for 32% of total tax revenue . . . .").

133. *See generally* Alan Cole, *Estate and Inheritance Taxes Around the World*, TAX FOUND. (Mar. 2015), https://files.taxfoundation.org/legacy/docs/TaxFoundation_FF458.pdf (listing those countries with an estate tax).

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lack of familiarity thus surrounds the transfer tax regime—and, thus, there is a lack of a positive, trusting mindset about it.

Consider the fact that when taxpayers make gifts and bequests, on an emotional level, they often expect to receive in return such things as approbation, respect, and spiritual remembrance. Low or nonexistent on their list of expectations is receiving a hefty tax bill for their generosity. This unexpected financial onus on the heels of being magnanimous, some commentators argue, breeds contempt toward transfer taxes,[134] propelling at least some taxpayers to take whatever circumvention measures are necessary to avoid its application.

Aside from taxpayers' private misgivings regarding the transfer tax regime, in the public domain, the transfer tax regime endures regular political attacks. For example, politicians routinely aver that transfer taxes constitute double taxation; and, as such, they smack of fundamental unfairness.[135] Along the same lines, the transfer tax has been pejoratively branded the *death tax*.[136] Such labeling foments the notion that to protect one's family from calamitous financial disasters associated with the imposition of such a tax, all tax-minimization strategies—legitimate and illegitimate—are fair game.

The litany of factors enumerated above—namely, (A) absence of third-party tax information reporting, (B) absence of meaningful penalties, (C) difficulties associated with detection, (D) difficulties associated with recordkeeping, (E) complexity of the transfer tax system, and (F) taxpayers' mindsets—contribute to the severe problems plaguing the transfer tax system, which are deeply embedded and hard to overcome. Below, however, are several suggested reform measures that would undoubtedly

134. *See* Joseph Thorndike, *Why Do People Hate Estate Taxes but Love Wealth Taxes?*, FORBES (Oct. 30, 2019, 10:27 AM), https://www.forbes.com/sites/taxnotes/2019/10/30/why-do-people-hate-estate-taxes-but-love-wealth-taxes/?sh=53060fe579e8 (explaining why the country generally reviles the estate tax).

135. *See, e.g.*, Edmund L. Andrews, *Death Tax? Double Tax? For Most, It's No Tax*, N.Y. TIMES (Aug. 14, 2005), https://www.nytimes.com/2005/08/14/business/yourmoney/death-tax-double-tax-for-most-its-no-tax.html [https://perma.cc/W56Q-PSCP] ("And while opponents contend that the estate tax is a 'double tax,' . . ."). Arguably, the transfer tax is not a double tax, *see* Jay A. Soled, *Reimaging the Estate Tax in the Automation Age*, 9 U.C. IRVINE L. REV. 787, 799–800 (2019), but such labeling nevertheless goes a long way toward casting a dark political shadow.

136. *See* GRAETZ & SHAPIRO, *supra* note 10, at 85–98 (tracing how right-wing think tanks formulated a campaign against the estate tax, labeling it the *death tax*).

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help narrow the transfer tax gap and help the nation regain its financial balance.

IV. Reform

While tax academics generally cannot reach a consensus on many tax policy issues, there is general agreement that closing the tax gap requires a multiprong approach.[137] In other words, there is no single policy initiative that will result in taxpayers automatically becoming tax compliant. Because there is no single "magic bullet" that will eliminate the tax gap, this part of the analysis offers three reform measures: (A) instituting an information return requirement upon the receipt of a gift or bequest, (B) imposing a tax penalty for failing to file a gift tax return, and (C) decoupling the gift and estate taxes. Together, these three reforms would go a long way toward bolstering the integrity of the transfer tax regime.

A. Extending the Use of Third-Party Information Tax Returns

As previously mentioned,[138] there is compelling evidence that issuing third-party tax information returns is a critical component of tax compliance. And virtually every time there has been an opportunity to extend their use, Congress has capitalized on it and expanded third-party tax information reporting requirements.[139] This approach has resulted in the annual issuance of billions of third-party tax information returns and the capture of untold revenue.[140]

Notwithstanding the ability of third-party tax information returns to rein in taxpayer noncompliance, some commentators have argued that prior to Congress imposing such requirements, it should undertake a cost-benefit analysis.[141] The benefit associated with mandates for third-party tax information returns speaks for itself in the form of a greater revenue yield.

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137. *See* Dave Rifkin, *A Primer on the "Tax Gap" and Methodologies for Reducing It*, 27 QUINNIPIAC L. REV. 375, 380 (2009); Olson, *supra* note 1, at 8.

138. *See supra* Section III.A.

139. *See, e.g.*, I.R.C. § 6050W (requiring information reporting for certain credit and debit card transactions). *See generally* Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733, 1739 (2010) (examining the utility of third-party reporting requirements).

140. *See* INTERNAL REVENUE SERV., INTERNAL REVENUE SERVICE DATA BOOK, 2022, at 54 tbl.22 (2022), https://www.irs.gov/pub/irs-pdf/p55b.pdf (indicating that the IRS received approximately 5.5 billion information returns in 2021).

141. *See generally* Lederman, *supra* note 139, at 1739–41 (pointing out that while third-party information returns can help close the tax gap, due to the administrative costs associated with their imposition, they should not be imposed willy-nilly).

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The cost is the administrative burden associated with preparing and submitting such third-party tax information returns. If the putative cost outweighs the putative benefit, Congress should reject the proposed third-party tax information requirement as being too burdensome and therefore unwarranted.[142] But because the projected size of the tax gap associated with the nation's transfer tax is large and likely expanding,[143] the benefit clearly outweighs the cost.

Therefore, Congress should expand third-party tax information return reporting so that the IRS has sufficient information to police tax compliance. One low-cost method that would put the IRS at a better information vantage point is two-prong in nature: first, every person who receives annual gifts that exceed the gift tax exclusion amount would have to report that aggregate sum on their Form 1040 (as nontaxable income) along with the donor's name; second, every beneficiary of an estate (e.g., individual, trustee, or charitable organization) who received a bequest beyond a certain dollar threshold (say, $100,000) would have an obligation to report such information on their income tax return (as nontaxable income) along with the decedent's name.

Those naysayers who contend that the costs of instituting such a requirement are too burdensome fail to realize that a prototype of such a reporting requirement already exists and, for decades, has been working efficaciously.

In the realm of the gift tax, consider the fact that every time a foreign person makes a gift to a U.S. taxpayer and the amount of the gift exceeds $100,000, the latter must report its receipt on Form 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts) even though there is no tax due and owing.[144] If the taxpayer fails to report the receipt of such a gift, the Code imposes a penalty equal to 5% of the unreported gift's value for each month that passes after the Form 3520's due date, with a maximum 25% penalty.[145] This requirement enables the

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142. Lederman explains this cost-benefit analysis as follows:

> However, on closer scrutiny, it becomes apparent that subjecting gifts to this kind of information reporting would be inefficient and ineffective. The donor/donee context necessarily involves parties who are not acting at arm's length. There is every incentive for parties who are close enough to give or receive a gift so substantial that it exceeds the annual exclusion under the gift tax simply to collude in avoiding the tax (or conveniently remain ignorant of the obligation).

Id. at 1757.

143. *See supra* Section II.C.

144. I.R.C. § 6039F(a).

145. *Id.* § 6039F(c).

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IRS to track the receipt of foreign gifts—and, to date, there has been no public outcry that this simple filing requirement is too onerous and should be repealed.

In the realm of the estate tax, consider the fact that every time a foreign decedent makes a bequest to a U.S. taxpayer and the amount of the bequest exceeds $100,000, the latter must report its receipt on Form 3520 even though there is no tax due and owing.[146] Once again, if the taxpayer fails to report the receipt of such a bequest, the Code imposes a penalty equal to 5% of the value of the unreported bequest for each month that passes after the Form 3520's due date, with a maximum 25% penalty.[147] Akin to the receipt of foreign gift reporting returns, this requirement enables the IRS to monitor the receipt of foreign bequests—and, to date, there has been no public outcry that this simple filing requirement is too onerous and should be repealed.

B. Imposing a Tax Penalty for the Failure to File a Gift Tax Return

For the transfer tax regime to retain its vibrancy, the gift tax must maintain its effectiveness.[148] Said somewhat differently, if the success of the gift tax teeters, the rest of the transfer tax regime is in jeopardy of collapsing.

An example illustrates this point. In 2025, suppose a taxpayer makes a $10 million gift to his son, fails to file a gift tax return, and dies twenty years later in 2045, bequeathing $10 million to his daughter and appointing his daughter as the executor of his estate. At least under current law, the failure-to-file penalty only applies if there is an actual tax due.[149] Under the hypothetical facts posited, there was no tax due and hence no penalty would apply. However, the taxpayer's daughter may not be aware of the taxpayer's earlier gift to her brother, and she may thus mistakenly believe that she has no obligation to file an estate tax return. Under such circumstances, the IRS's chances of detecting the daughter's filing dereliction would be negligible to nonexistent.

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146. *Id.* § 6039F(b) (indicating that the term *foreign gift* includes bequests).

147. *Id.* § 6039F(c).

148. *See, e.g.*, Amber N. Becton, Comment, *Taxation of Intrafamily Transfers: Problems and Proposed Solutions*, 76 TENN. L. REV. 771, 785 (2009) ("A primary purpose of the gift tax is to serve as a 'backstop' to the estate tax by preventing those whose estates would be subject to the estate tax from giving away their wealth during their lifetimes and thus avoiding the estate tax.").

149. *See supra* note 94 and accompanying text.

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The foregoing example vividly illustrates the need for Congress to revamp the penalty structure for the gift tax. In a nutshell, Congress should penalize those taxpayers who make taxable gifts and then fail to timely file a gift tax return. In other words, akin to the receipt of foreign gifts or bequests, taxpayers who make taxable gifts and fail to timely file a gift tax return should be subject to a 5% monthly penalty, up to a maximum percentage of 25%, on the fair market value of the property that they gratuitously transfer.[150]

Instituting this requirement would result in taxpayers having to recalibrate their failure-to-file risk. In the prior example, the taxpayer who originally made a $10 million gift to his son and failed to file a gift tax return might no longer be so carefree and cavalier; instead, knowing that his failure to file could come at the theoretical price tag of a $2.5 million penalty, he would likely be more apt to become transfer tax compliant.

C. Decoupling the Gift and Estate Tax Regimes

Time has never been a proverbial friend to recordkeeping. The longer records must be maintained, the greater the jeopardy that they will be lost, damaged, forgotten, or destroyed.[151] While imperfect, the income tax system relies upon Earth making one complete rotation around the sun as the appropriate metric to measure a taxpayer's earnings for the time period in question.[152] As previously pointed out,[153] however, when considering the transfer regime, this is not the case, and record maintenance could theoretically extend to a century or longer.

A glimpse backward indicates that elongated recordkeeping for gratuitous transfers (which currently extend over a person's entire lifetime) was not always the case. Congress instituted the estate tax in 1916 and the gift tax in 1924.[154] For decades thereafter, the gift and estate taxes functioned independently of each other. If a taxpayer made taxable gifts beyond a certain monetary threshold, the taxpayer paid an immediate gift tax;[155] upon the taxpayer's demise, depending upon the taxpayer's net

150. *See supra* notes 144–147 and accompanying text.
151. *See supra* notes 104–106 and accompanying text.
152. *See* I.R.C. § 441(a)–(b).
153. *See supra* note 116 and accompanying text.
154. *See supra* notes 21–22 and accompanying text.
155. *See* Revenue Act of 1924, Pub. L. No. 68-176, § 319, 43 Stat. 253, 313 ("For the calendar year 1924 and each calendar year thereafter, a tax equal to the sum of the following is hereby imposed upon the transfer by a resident by gift during such calendar year . . . ."). In

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worth at that time, an estate tax would apply with the taxpayer's prior gifts having absolutely no bearing upon this computation.[156]

Beginning in the 1970s, the academic community propounded the notion that the gift and estate taxes should be joined together.[157] And this made theoretical sense: lifetime and testamentary transfers are both gratuitous in nature, and thus a common rate structure and lifetime exemption hypothetically should apply. In 1976, Congress heeded this advice and amalgamated the gift and estate taxes into one system, and it has endured as such for the past half century.[158]

But as evidenced by the size of the transfer tax gap and the problems with flawed recordkeeping, Congress should give serious thought to decoupling the two systems and having the gift and estate taxes return to their historical origins.[159] In lieu of the status quo, here is the proposal:

1932, Congress changed the gift tax in a manner that it would apply to the cumulative gifts that a taxpayer made:

> The tax for each calendar year shall be an amount equal to the excess of—
>
> (1) a tax, computed in accordance with the Rate Schedule hereinafter set forth, on the aggregate sum of the net gifts for such calendar year and for each of the preceding calendar years over
>
> (2) a tax, computed in accordance with the Rate Schedule, on the aggregate sum of the net gifts for each of the preceding calendar years.

Revenue Act of 1932, Pub. L. No. 72-154, § 502, 47 Stat. 169, 246.

156. *See* Jerome Kurtz & Stanley S. Surrey, *Reform of Death and Gift Taxes: The 1969 Treasury Proposals, the Criticisms, and a Rebuttal*, 70 COLUM. L. REV. 1365, 1367 (1970). This process proceeds as follows:

> The estate and gift tax system first imposes a tax on the aggregate amount of gifts, less certain allowed exemptions, that an individual makes during his lifetime. It imposes a separate tax, unrelated to the amount of lifetime gifts, on the amount of property included in the individual's "taxable estate" at the time of his death.

Id.

157. *See id.* at 1368.

> It would seem obvious that any notion of equity would require that aggregate wealth transfers of equal size should bear equal amounts of taxes. Moreover, progressivity, a notion accepted in theory, requires that the greater the transfer, the greater should be the ratio of the amount of the tax to the amount of the transfer.

Id.

158. *See* Tax Reform Act of 1976, Pub. L. No. 94-455, §§ 2001–2010, 90 Stat. 1520, 1846–48 (codified as amended throughout 26 U.S.C.) (unifying estate and gift taxes and adding a tax on generation-skipping transfers).

159. *See generally* Jay A. Soled, *Gift and Estate Taxes: The Case for Deunification*, 57 HARV. J. ON LEGIS. 439, 442–50 (2020) (describing the salient features of the independent gift and estate taxes).

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during life, taxpayers could continue to make annual exclusion gifts (e.g., birthday and graduation presents) and bear no gift tax. However, taxpayers making annual gifts beyond this exclusion amount would bear an immediate gift tax for the year in question; a flat tax rate (equal to the maximum estate tax rate) would determine the amount of tax due. When the taxpayer passed away, an independent estate tax would apply, with the amount of prior gifts playing no role in its determination.

Instituting this reform would obviate the need for long-term recordkeeping and help narrow the transfer tax gap. Years and decades after gifts were made, taxpayers would no longer have to scurry around to locate documents in their possession or, worse, in the theoretical possession of their parents, grandparents, or other loved ones—a task most likely to prove futile even to those indefatigable in their searches.

The proposals set forth above are specifically designed to help close the transfer tax gap. Granted, adopting these proposals would not eliminate "legitimate strategies" that taxpayers regularly employ to minimize their transfer tax burdens. Such strategies include, but are not limited to, the use of grantor-retained income annuity trusts targeted to eliminate any gift tax imposition, the establishment of Crummey trusts designed to exploit the annual gift tax exclusion, and the manipulation of minority and marketability discounts designed specifically to strategically diminish the value of closely held business interests to minimize transfer tax exposure.[160] These techniques and others like them significantly narrow the transfer tax base, robbing it of its vibrancy.

However, while these "legitimate strategies" tug at the integrity of the transfer tax regime, those that are illegitimate (e.g., the underreporting of and failure to report taxable gifts and bequests) do even greater damage. They subvert the economic fabric, namely, the collection of taxes—an exercise that holds civil society together. Congress should therefore take whatever measures are necessary to eliminate such corrosion from the system. An excellent way to start would be the institution of the three proposals enumerated above.

V. Conclusion

Over the course of the last several decades, closing the tax gap has proven elusive, and it has remained a stubborn feature of the nation's tax

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160. *See supra* Section II.B.

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system. This has depleted the nation's coffers and has allowed trillions of much-needed tax revenue to escape taxation.

Therefore, Congress must make concrete efforts to narrow the tax gap. Most recently, Congress heeded this advice, granting additional funding to the IRS to the tune of approximately $79 billion.[161] These funds are supposed to help modernize the agency, augment customer service, and add auditors.[162] The IRS's utilization of these funds for these designated purposes is calculated to yield billions of dollars in additional revenue.[163]

But more must be done—and a good way to start would be to institute reform measures such as those advocated in this analysis to help buoy taxpayer compliance in the transfer tax realm. Instituting the practical measures that this analysis propounds would go a long way in helping the transfer tax regime fulfill its historic objectives, namely, raising revenue and curtailing inherited wealth.[164] By restoring integrity to the transfer tax regime, Congress would have additional tax revenue to accomplish a whole host of objectives, including expanding public works projects, paying down the deficit, and reducing taxes; furthermore, a more robust transfer tax system would greatly diminish the chances for a monarchy-like political dynasty to arise.

This analysis sets forth a viable path to achieve these sought-after outcomes; whether such objectives will be achieved is only a question of political will.

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161. Inflation Reduction Act of 2022, Pub. L. No. 117-169, § 10301, 136. Stat. 1818, 1831–32.

162. *See* BRENDAN MCDERMOTT, CONG. RSCH. SERV. INSIGHT, IN11977, IRS-RELATED FUNDING IN THE INFLATION REDUCTION ACT 2 (2022), https://crsreports.congress.gov/product/pdf/IN/IN11977 ("The [Inflation Reduction Act] gave the IRS $45.6 billion for tax enforcement activities such as hiring more enforcement agents, providing legal support, and investing in 'investigative technology.' The funds can also be used to monitor and enforce taxes on digital assets such as cryptocurrency.").

163. *Id.* ("The Congressional Budget Office estimates that the additional enforcement measures funded by this law will generate $204 billion in revenues through FY2031, although such estimates are highly uncertain.").

164. *See supra* notes 24–25.

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