

## CONSIDERATIONS FOR "SIMPLE" ESTATE PLANNING

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The purpose of this memorandum is to touch upon some areas which may be of interest to you while, hopefully, sparing you the tedium associated with a recitation of the estate planning process from Genesis to Revelation. If any of the following items pique your curiosity, please give us a call.

### **I. The Probate Process - Administration of Decedent's (Deceased) Estate.**

A. The theory behind the probate process is relatively simple. At the time of the person's death, the individual "nominated" by the decedent to execute ("Executor") the decedent's wishes (as expressed in his "Will"), or, administer ("Administrator") the decedent's estate in the event he or she dies without a Will ("intestate") is charged by state law and by the local Probate Court to accumulate, identify and appraise all assets of the estate, pay lawful debts, expenses and taxes (discussed further below), distribute the balance to the decedent's beneficiaries (variously referred to as "heirs", "legatees" [where personal property is involved], or "devises" [where real property is involved]), thereafter reporting the entire process to the Probate Court.

B. As one might expect, although the theory is simple, the process is governed and described in hundreds of pages of laws known as the "Ohio Revised Code" which variously describes (1) admission of the will to probate, (2) appointment of the Executor, (3) rights of surviving spouse, (4) sale of personal property and real estate, etc., etc., etc.

C. In addition to the foregoing, there are many junctures during the probate process at which litigation may take place, for example, (1) action to construe a Will, (2) Will Contest, (3) actions to remove the Executor or Administrator (also referred to as "Fiduciaries").

D. Each of Ohio's 88 counties includes a Probate Court with responsibility to oversee the entire process.

### **II. Assets Subject to Probate, i.e., "Probate Assets".**

A. Most people assume that if they have a Will, the Will shall govern the disposal or disposition (also referred to as "testamentary disposition") of that person's assets. This is only partially true! A Will acts upon only those assets which are titled solely in the name of the decedent at the time of his or her death, so-called "Probate Assets".

B. For example, real property in the name of "John Doe" represents probate assets which will be administered in the Estate of John Doe. On the other hand, real property in the name of "John Doe and Mary Doe", tenants in common, will be administered 50% in the Estate of John Doe.

C. It should also be noted that, with the exception of charges for certain taxes, only probate assets are subject to claims by creditors of the estate. Property held in other forms may escape the reach of such creditors.

### **III. Assets Not Subject To Probate, i.e., "Non-Probate Assets".**

A. By definition, so-called "Non-Probate Assets" are those assets which are not affected by a decedent's Will and are not administered in a decedent's estate through the Probate Court. This is also referred to as "Non-Testamentary Disposition" of assets.

B. Examples of this type of property include joint survivorship bank accounts, insurance policies payable to named beneficiaries, annuities payable to named beneficiaries, accounts with "P.O.D." (Payable On Death) designations, employment benefits with named beneficiaries, joint and survivorship real property, real property with Transfer on Death (TOD) designation, and life insurance payable to beneficiaries other than the estate or the decedent. In each of the foregoing cases, the decedent has provided for "non-testamentary disposition" of the asset through the use of a contract with a third party such as a bank, insurance company, employer or, in the case of real property, by operation of law based upon the manner in which the decedent took title in his or her deed.

C. PLEASE NOTE: In planning the distribution of your estate, you should be very careful to identify the "probate assets" and "non-probate assets" to assure that you understand the manner in which such assets will pass to your beneficiaries. If, on the other hand, your thought process is such that you simply lump all property into one classification and assume that your Will will take care of everything, you may be mistaken.

### **IV. Conversion of Assets from Probate to Non-Probate Status.**

A. The simple expedient of converting title to property from the name of a single individual to either (1) jointly owned, or (2) payable on death, will serve to take assets out of the "probate" category and convert them into the "non-probate" category, if that is desirable. On the other hand, assets currently owned in joint names can be converted by going in the other direction. Where the owners are husband and wife, transfer by gift back and forth creates no problems from a gift tax standpoint. However, if assets are jointly owned by parent-child, siblings, or some other non-spousal format, then care must be taken to avoid gift tax exposure.

### **V. Avoiding Probate.**

A. As you know, avoidance of probate has been a very popular subject for the last 20 years. The rationale has been that the time involved in the probate process along with the expense of probating assets merits avoidance where possible. While this may be accurate in certain cases, in other cases that may be a deceptively attractive approach which, however, is not merited by the asset mix, family considerations, estate tax considerations and the like.

B. In cases involving larger estates, appropriate tax and family planning may dictate the "non-avoidance" of probate in order to funnel family assets to the second

generation as opposed to adding to the estate of the surviving spouse which will, in turn at the death of such spouse, aggravate the overall estate tax payable when viewed as a family unit, as opposed to the individual estate.

## **VI. Estate Taxes - Ohio and Federal.**

A. The state and federal governments impose a so-called "transfer tax" referred to as an "Estate" tax. This is a tax imposed upon the transfer of assets, as opposed to taxes on "income", and, are paid by the estate prior to distributions made to beneficiaries. Many years ago, this was termed an "inheritance tax" which was levied at the beneficiary level, however, this is no longer the case. Property inherited through an estate is not taxed to a beneficiary unless or until that beneficiary utilizes those assets to generate separate, subsequent income which would then be subject to federal and local income taxes. It should also be noted, however, that "income" generated during administration of the state will be subject to a separate "fiduciary income tax return", however, again, this occurs prior to distribution to beneficiaries.

B. On the federal level, there is a so-called "estate tax exemption" which provides an effective exemption available to every individual which, customarily, is more popularly referred to by the deductible equivalent amount of \$1,000,000.00 in 2003. In other words, for federal estate tax purposes, until an estate exceeds \$1,000,000.00, there is no requirement to file a federal estate tax return or pay taxes. This figure increases to \$1,500,000.00 (2004-2005), \$2,000,000.00 (2006-2008), \$3,500,000.00 (2009) and is scheduled to be repealed (for one year only) in 2010.

C. Historically, the Ohio estate tax picture has not been nearly so liberal; however, recent legislation has improved things for persons dying after January 1, 2001. The estate tax credit was increased from \$500.00 to \$6,600.00, effectively increasing the exemption from the previous \$25,000.00 to \$200,000.00. After January 1, 2002, the credit/exemption equivalent was further increased to \$13,900.00/\$338,333.00.

D. All assets are appraised as of the date of death of the decedent. Parenthetically, this date of death appraisal also results in a so-called "stepped up basis" which means that assets subsequently transferred from a decedent's estate to beneficiaries are valued for tax basis purposes in the name of the beneficiary at the date of death value. This can result in avoidance of substantial capital gains and can be utilized as an effective estate planning technique to avoid substantial tax on the capital gain built up over the years.

E. The federal estate tax rate (once the \$1,000,000.00 threshold has been reached) starts at 41% and runs up to a confiscatory 50%! For Ohio purposes, after January 1, 2001 the rate starts at 5% and reaches a peak at 7% for estates in excess of \$500,000.00. Obviously, it behooves you to plan to avoid or mitigate estate taxes to the extent possible. Both federal and state estate taxes are subject to a so-called "marital deduction" which, again, is a valuable planning tool.

F. Computation of estate taxes is very similar to your own personal tax return. In other words, assets are listed at their date of death appraised value, expenses of administration, charitable gifts and the like are then deducted to arrive at a "net taxable estate" before the tax rate is applied. The federal estate tax return also provides for a credit for state death taxes paid.

## **VII. Constructing the Will/Preparation.**

A. Executor. You "nominate" a person to act as your Executor, as well as an alternate in the event that the original person cannot serve. The Probate Court actually "appoints" the Executor. Customarily, this person is normally a spouse or other close relative and should be a resident of the county, or, at least the State of Ohio. Non-residents of the State of Ohio may serve in a fiduciary capacity but only as Co-Executors. In other words, there must be a local Executor over which the Probate Court may exert jurisdiction. In addition to individuals, Trust Departments of banks may act as fiduciaries as well.

B. Bond. In the absence of language in your Will dispensing with bond, surety bonds are required of all fiduciaries appointed by the Probate Court.

C. Specific Bequests. Specific gifts may be made in your Will to individuals, organizations, charities, and the like.

D. General (Residuary) Bequests. After all specific bequests have been completed, the balance of your property is then designated for distribution. Frequently, in the case of spouses, there are no specific bequests; each spouse simply gives all of the spouse's property, real and personal, to the other spouse.

E. Levels Subsequent to Spousal Gifts. You should be prepared to designate those beneficiaries to whom you would like gifts made in the event of the prior death of your spouse, the prior death of your spouse and children, and so on, as far down as you may desire. This is always a good opportunity to make charitable contributions which would be deductible for estate tax purposes.

F. Designation of Guardian. Again, you "nominate" a person or person to act as guardian of your minor children; the Probate Court actually "appoints" the guardian based upon the Court's independent determination that the person nominated is in fact suitable to serve.

G. Miscellaneous Provisions. Customarily, the balance of the Will is given over to a recitation of powers bestowed upon the Executor. Since the nature of property has expanded exponentially over the years (originally it was simply real estate and personal property; now, we have real estate interests, general and limited partnership interests, interest in real estate investment trusts, annuities, employment benefits, and untold other types of personal property), it is necessary to use a broad brush to designate as many powers as possible for use by the Executor in fulfilling his or her duties. Consequently, you should not be surprised to see references to powers which may or may not have anything to do with your current inventory of assets.

## **VIII. Miscellaneous Additional Estate Planning Documents.**

In addition to the "simple" Wills, your particular factual situation may suggest the use of one or more trusts (such as credit shelter/bypass trusts, contingent trusts, Charitable Remainder Trusts, GRITS, GRATS, GRUTS, A-B Trusts, etc.), Living Trusts (for example, if you have real property in other states, this vehicle might make

sense), Living Wills, Powers of Attorney, and Health Care Powers of Attorney. Any one or more of the foregoing may be appropriate for you.

The foregoing probably represents much more than you ever wanted to know about this entire area, however, if it touches upon one or more concerns of yours, or, suggests areas for discussion, it will have served its purpose.

Yours very truly,  
CAMPBELL,  
HORNBECK,  
CHILCOAT  
& VEATCH LLC

David B. Hornbeck,  
Member  
7650 Rivers Edge Drive  
Suite 100  
Columbus, Ohio 43235  
Phone: (614) 846-2000  
Fax: (614) 846-2003

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