



Estate Planning Considerations for Ohio Families

Section 9

Ohio and Federal Estate Settlement Costs

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Competent estate planning requires consideration of several different kinds of costs. The basic provisions of the most common costs are discussed here. You may read about them in the order presented or click on the list above to go immediately to the information you are interested in.

Administration Costs

The administration costs represent executor, attorney, appraisal, probate, and court fees. Every estate will incur some administration costs. They may vary considerably from estate to estate due to the size and complexity of the estate. An estimate of 5 percent on a smaller estate, or 4 percent on a larger one should be reasonable. These costs should be discussed openly before the services of a professional are employed.

The probate process is a court procedure for settling the personal and business affairs of a decedent by formally proving the validity of a will and establishing the legal transfer of property to beneficiaries. Probate court costs are relatively small compared to the balance of settlement costs. Probate costs will usually range from \$125 to \$300 for an estate. After all assets are inventoried and valued, debts and taxes paid, tax clearance letters received, guardianships settled, and the balance of assets distributed to the heirs, the estate is closed.

You can learn more about probate at the Ohio State Bar Association and Cuyahoga County Probate Court websites:

Probate: <http://www.ohiobar.org/conres/pamphlets/article.asp?ID=17>

Probate Law: http://www.ohiobar.org/downloads/conres/Law_and_You_9.pdf

Cuyahoga County Probate Court website: http://www.cuyahoga.oh.us/probate/faq/faq_estates.htm#

- WHAT IS A PROBATE ESTATE?
- WHY IS A PROBATE ESTATE NECESSARY?
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Ohio Estate Taxes

The second most likely estate settlement costs to be incurred are Ohio Estate Taxes. The basic Ohio estate tax is

levied against the value of a resident decedent's gross estate less deductions and exemptions. Table 1 summarizes the Ohio Estate Tax rates. Each estate also receives an estate tax credit of \$13,900, for deaths after January 1, 2002. The credit offsets the taxes on taxable estates up to \$338,333. Additional tax is due when the federal state death tax credit exceeds the Ohio tax paid.

Table 1. Ohio Estate Brackets	
Taxable Estate	Tax
First \$40,000	2%
\$40,001–\$100,000	\$800 + 3% over \$40,000
\$100,001–\$200,000	\$2,600 + 4% over \$100,000
\$200,001–\$300,000	\$6,600 + 5% over \$200,000
\$300,001–\$500,000	\$11,600 + 6% over \$300,000
Over \$500,001	\$23,600 + 7% over \$500,000

Property included in the gross estate for Ohio taxes includes:

1. Decedent's share of all property in which the decedent, at death, owned a fractional or entire interest (except real property outside Ohio);
2. Insurance on the life of the decedent payable to their estate;
3. Property "given away" by the decedents during their lifetime in which they kept some interest for their lifetime;
4. For annual gifts in excess of \$10,000 to one person, within three years of death, the amount over \$10,000 will be included;
5. One-half of the value of property owned with a spouse in joint tenancy with rights of survivorship;
6. The portion of other property owned in joint tenancy contributed to the tenancy by the decedent. (The total is presumed to be in the estate unless the surviving owner can prove otherwise.)

Insurance on the life of the decedent, payable to a beneficiary other than the estate, is not includable for Ohio estate tax purposes. Insurance payable to the estate and insurance contracts, such as matured endowment or supplemental contract wherein the insurance or risk feature ceased prior to death, are includable for Ohio estate tax purposes.

Allowable deductions include:

1. Debts and other claims against the estate, funeral expenses, costs of administering the estate;
2. Losses from fire, storm, and other casualty or theft during the settlement of the estate;
3. The amount of money or property left to charitable, religious, and educational organizations; and
4. The amount of money or property passing without reservation to a surviving spouse that qualifies as the "marital deduction." Since July 1, 1993, the marital deduction is unlimited, to coincide with the federal estate tax marital deduction.
5. For estates where death was on or after January 1, 2001, there is a deduction of up to \$675,000 for the decedent's qualified interest in a family owned business.

Since January 1, 2002, resident estates with gross values under \$338,333 and no real property are exempt from filing returns. Ohio estate taxes are payable nine months from the date of death to the treasurer of the county where the estate is administered.

Effective January 1, 2001, regardless of the date of death of the decedent, the tax commissioner no longer requires the inventory of a safe deposit box upon the death of the owner, co-owner, or any other person having access to the box. This policy change applies to both resident and non-resident decedents of the State of Ohio.

For more information about Ohio Estate Taxes, go to the estate tax information section of the Ohio Department of Taxation website at:

http://www.state.oh.us/tax/individual_taxes_estate.html

Federal Estate Taxes

Here we discuss in detail how to compute federal estate taxes. At the bottom of this discussion Tables 5 and 6 show estimated settlement costs for married persons and single persons with different sizes of estate. It is helpful to know how the taxes are computed in order to avoid unnecessary estate planning and paying unnecessary tax. The taxes and other costs for the estates of a couple with a net worth of \$1,850,000 are shown in Section 10: Sample Estate Tax Calculations and an Illustration of Potential Savings from a Simple Estate Plan. There you can see how the taxes are actually computed for the two estates of the couple.

The federal estate tax is levied at death on all the property of a decedent, whether real or personal, tangible or intangible, and wherever situated, except real property situated outside of the United States. The total value of the items is called the “gross estate.” The tax is imposed upon the taxable estate (gross estate less allowable deductions) of a decedent before it is divided and not upon the share of the estate received by a particular beneficiary.

Filing Requirements

IRS Form 706 must be filed by every citizen or resident of the United States whose gross estate exceeds the applicable exclusion amount shown in Table 2. The return should be filed within nine months after death unless an extension of time has been requested and granted by the Internal Revenue Service.

Property included in the gross estate for federal taxes is the same as for Ohio taxes above, with these exceptions:

1. All property owned in which the decedent owned a fractional or entire interest (except real property owned outside the United States) is included.
2. Insurance on the life of the decedent payable to beneficiaries if the decedent had any rights of ownership in the policy is included.
3. For all annual gifts of over \$11,000 to one person, the amount over \$11,000 per person per year will be included. The \$11,000 annual gift is indexed for inflation, but will only change in increments of \$1,000. (Deductions are the same as those listed for Ohio taxes.)

Marital Deduction

There is an unlimited deduction between spouses who are U.S. citizens. Thus, any amount you leave to your spouse transfers free of federal and Ohio estate taxes. This includes a life interest passing to the spouse. *This can be a tax trap!* If either spouse, or the couple jointly, has a net worth of \$1,000,000 or more, good tax planning usually suggests that when the first spouse dies they not leave all their property to the surviving spouse outright, even though they can do so tax free. Usually they should put at least part of their property into a trust or life estate, or leave it directly to other heirs. Doing so will keep those assets from being taxed in the surviving spouse’s estate. This does *not* mean you are slighting your spouse! If your spouse needs or wants to use the property or the income from it, a trust or life estate can be set up so they continue to use the property and get the income, if any, from those properties.

Your estate planning advisors can help you decide whether it makes sense for you to leave some property to a trust, life estate, or other heirs. They also can help you decide which property, and whether to use a trust or life estate, or leave it to others. If your spouse is not a U.S. citizen, a special type of trust will be needed if you want to take advantage of the marital deduction.

Balancing Estates

One of the basic principles of reducing estate taxes and settlement costs for large estates is to balance the size of the estates of a married couple. That is, to transfer assets between the husband and wife so they both have about the same amount of property, i.e., balanced ownership. This naturally follows the “tax trap” discussion immediately above so we include it here. As discussed above, one of the tax planning objectives for people with large estates is to keep all of a couple’s wealth from ending up in the surviving spouse’s estate and being subject to federal estate tax.

One way this can become a problem is when one spouse already has most of the couple's assets in their name and their spouse, who does not own much property, dies first. True, there will not be any taxes when the first one dies, but we now have a single widow or widower with a large estate and no marital deduction. Thus, most of the couple's assets will be subject to tax when the second spouse dies. You can see the difference in the taxation of single persons and married persons in Tables 5 and 6 below.

One way to minimize the problem is to have both spouses own a similar amount of property. Then whoever dies first should use a trust or life estate, or will property to other heirs so all of the couple's assets will not end up in the surviving spouse's estate. Under the gift tax rules, spouses who are U.S. citizens can transfer unlimited assets between themselves with no tax consequence so there is no tax or legal problem in making such transfers. However, there will be some legal and filing costs to change the deeds for real estate.

However, from the "human side" it is sometimes very difficult for the spouse who has most of the assets to transfer them to their spouse. It is often complicated by farms that have been in one family for years, spouses who have remarried and have "his" and "her" children, relationships that are unstable, etc. For large estates, the potential tax savings can amount to several hundred thousand dollars, but balancing estates still may not be an appropriate step for some families.

Federal Estate Tax Calculations

Beginning in 2002, federal estate taxes do not apply unless the person who died has a taxable estate of more than \$1,000,000. This occurs because in 2002 and 2003 the tax on the first \$1,000,000 is offset by the federal estate tax applicable exclusion amount (AEA). The applicable exclusion amount for the years 2002-2009 is shown in Table 2. January 1, 2010, the federal estate tax is repealed; however, unless Congress intervenes, one year later, all provisions of the 2001 tax act return to their state at the time of enactment of the 2001 legislation (June 7, 2001).

Year of Death	Amount Excluded
2002-2003	\$1,000,000
2004-2006	\$1,500,000
2007-2008	\$2,000,000
2009	\$3,500,000
2010	Estate tax repealed
2011 ¹	\$1,000,000
¹ If Congress does not act by 12/31/10 the exemption reverts back to the exclusion amount specified in the prior tax law.	

Federal Estate Tax Rates

Tax rates used to compute federal estate and gift taxes are shown in Table 3. However, the applicable exclusion amounts (AEA) shown in Table 2 offset the taxes on the first \$1,000,000 in 2002 and 2003, so no tax is paid on taxable estates of \$1,000,000 or less.

For example, using the table, the taxes on an estate of \$1,200,000 appear to be \$427,800. That is, \$345,800 on the first million, plus 41% of the remaining \$200,000. However, the 2002 AEA of \$1,000,000 offsets the taxes on the first \$1,000,000, or \$345,800. So the federal estate taxes payable on the \$1,200,000 estate are \$82,000. Thus, unless an individual taxable estate in 2002 or 2003 is more than \$1,000,000 no federal estate or gift tax is owed. And, the AEA goes up to \$3,500,000 in 2009.

Table 3. Unified Tax Rate Schedule

Amount subject to tentative tax		Tax on amount in column 1	Tax rate on excess over amounts in column 1*
Exceeding	But not exceeding		
\$ ---	\$ 10,000	\$ ---	18%
10,000	20,000	1,800	20%
20,000	40,000	3,800	22%
40,000	60,000	8,200	24%
60,000	80,000	13,000	26%
80,000	100,000	18,200	28%
100,000	150,000	23,800	30%
150,000	250,000	38,800	32%
250,000	500,000	70,800	34%
500,000	750,000	155,800	37%
750,000	1,000,000	248,300	39%
1,000,000	1,250,000	345,800	41%
1,250,000	1,500,000	448,300	43%
1,500,000	2,000,000	555,800	45%
2,000,000	2,500,000	780,800	49%
2,500,000	3,000,000	1,025,800	50%

* For individuals dying and gifts made after 2002, the top estate and gift tax rate (and the generation skipping transfer tax rate) will drop to the following levels: 49% (2003), 48% (2004), 47% (2005), 46% (2006) and 45% (2007-2009). These estate tax rates and the generation skipping tax are repealed after 2009 unless Congress takes further action.

The top gift tax rate for gifts made in 2010 will be 35%. The applicable exclusion amount for federal gift tax purposes remains at \$1,000,000, even after repeal of the federal estate tax in 2011.

It is important to note that the tax rates on any portion of an estate that exceeds the applicable exclusion amount are quite high. The tax rate is 41% from \$1,000,000 to \$1,250,000 which, due to the applicable exclusion amount, are the first dollars taxed. The tax rate goes up for larger estates. However, as the footnote to Table 3 explains, the highest tax rate is being reduced 1% per year until 2007 when it reaches 45%.

Credits for State Death Taxes

A credit is allowed against the federal estate tax for estate, inheritance, legacy, or succession taxes actually paid to any state or the District of Columbia on account of property included in the gross estate.

For individuals dying in 2001, the amount allowed as a credit is limited to an amount based on the decedent's adjusted taxable estate and is computed under the state death tax credit shown in Table 4. The "adjusted taxable estate" is the taxable estate (gross estate minus deductions) reduced by \$60,000.

For deaths in 2002 the credit is reduced from the level in Table 4 by 25%, for 2003 it is reduced 50%, and 75% in 2004. For persons dying after 2004, the state death tax credit is repealed and replaced with a new deduction for state death taxes.

Table 4. Computation of Maximum Credit for State Death Taxes (Based on Federal Taxable Estate)			
Adjustable Taxable Estate¹		Amount in Column 1	Rate of Credit on excess Over Amount in Column 1 (%)
Equal to or More Than	Less Than		
\$ 0	\$ 40,000	\$ 0	0
40,000	90,000	0	0.8
90,000	140,000	400	1.6
140,000	240,000	1,200	2.4
240,000	440,000	3,600	3.2
440,000	640,000	10,000	4.0
640,000	840,000	18,000	4.8
840,000	1,040,000	27,600	5.6
1,040,000	1,540,000	38,800	6.4
1,540,000	2,040,000	70,800	7.2
2,040,000	2,540,000	106,800	8.0
2,540,000	3,040,000	146,800	8.8
3,040,000	3,540,000	190,800	9.6
3,540,000	4,040,000	238,800	10.4
4,040,000	5,040,000	290,800	11.2
5,040,000	6,040,000	402,800	12.0
6,040,000	7,040,000	522,800	12.8
7,040,000	8,040,000	650,800	13.6
8,040,000	9,040,000	786,800	14.4
9,040,000	10,040,000	930,800	15.2
10,040,000	---	1,082,800	16.0

¹For purposes of this table, Adjusted Taxable Estate means the taxable estate reduced by \$60,000.

As an example, the rates of federal estate tax credit for state death taxes on taxable estates of \$640,000 to \$840,000 would be \$18,000 plus 4.8 percent of the excess over \$640,000 (Table 4). The credit shown in the table is the maximum, if at least that much state tax was paid. In case the surviving spouse dies soon after their mate, there is credit available for previously paid taxes.

If federal estate taxes were paid on property recently inherited, some or all of this tax is allowed as a credit against this estate's tax. The first death would have to have been not more than 10 years earlier. If within two years, there is a 100% credit. The credit decreases by 20% each 2 years. Credit for death taxes paid to foreign countries is also allowed.

Estimated Estate Settlement Costs

Table 5 shows estimated estate settlement costs for single persons who die in 2003 with different sizes of estates. There are several important observations one can make from this table.

Single persons include widows and widowers who have not remarried plus people who have never married. Therefore, more than half of the population will die as a single person. The taxes for a married person are calculated much differently and the estate settlement costs for a married person with a large estate are frequently much less than for a single person (see Table 6 below).

Ohio estate taxes (discussed above) do not become effective until the taxable estate reaches \$338,333. So, for small estates the biggest costs are administrative costs.

The percentage of the estate taken by settlement costs is fairly low until the estate gets larger than \$1,000,000. That occurs because the “Applicable Exclusion Amount” (discussed above) eliminates the federal estate tax on estates up to \$1,000,000. The largest costs for estates under \$1,150,000 or so, are administrative costs and Ohio estate taxes. The cost may seem high, but even together they frequently take less than 10% of the estate when the estate is less than \$1,000,000.

Once the federal estate taxes become effective they take a rapidly increasing portion of the estate. The “Percent of Estate Taken” (last column) goes up dramatically as the estate increases from \$1,500,000 to \$3,000,000. There is no federal estate tax at \$1,000,000, but the federal estate tax is more than all other costs when the estate reaches \$1,500,000. This helps one understand why so much effort in estate planning is expended in keeping all of a “wealthy couple’s” assets from ending up in the surviving spouse’s estate. The taxes on single decedents who are wealthy can be quite high.

The last section of this bulletin “Sample Estate Tax Calculations and An Illustration of Potential Savings From a Simple Estate Plan” shows how a hypothetical couple with substantial assets might be taxed. The example is followed by a simple alternative plan that illustrates a simple and inexpensive plan that greatly reduces their estate settlement costs.

Table 5. Estimated Estate Settlement Costs for a Single Person or Surviving Spouse, Death Occurs in 2003, \$1,000,000 Applicable Exclusion Amount					
Net Estate¹	Admin. Costs²	Ohio Estate Tax³	Federal Estate Tax After State Tax Credit⁴	Total Costs	Percent of Estate Taken
\$50,000	\$2,500	\$0	\$0	\$2,500	5.0%
\$200,000	\$10,000	\$0	\$0	\$10,000	5.0%
\$500,000	\$25,000	\$8,200	\$0	\$33,200	6.6%
\$750,000	\$33,750	\$24,838	\$0	\$58,588	7.8%
\$1,000,000	\$40,000	\$41,900	\$0	\$81,900	8.2%
\$1,500,000	\$60,050	\$75,500	\$155,920	\$289,420	19.3%
\$2,000,000	\$70,000	\$109,800	\$356,220	\$536,020	26.8%
\$3,000,000	\$105,000	\$177,350	\$787,170 ⁵	\$1,069,520	35.7%

¹ Gross estate (total assets) less debt and final expenses.
² Assumes executor took reduced or no fee.
³ Taxable estate for Ohio and federal estate tax calculations equals net estate minus administration costs.
⁴ Credit for Ohio estate taxes paid is reduced by 50% for deaths in 2003.
⁵ The maximum estate tax rate in 2003 is 49%.

Table 6 shows estimated estate settlement costs for married persons who die in 2003 and leave all their assets to their surviving spouse. The question of how much to leave outright to a surviving spouse is an extremely important question. In Table 6 we assume all of a married person’s assets are left to a surviving spouse. We are not advocating this disposition, but illustrate it because it is a very common practice. It is not generally advised for couples who have a substantial net worth (joint net worth in excess of \$1,000,000) that may be subject to federal estate taxes.

There are several important observations one can make when viewing this table. First and foremost, the estate settlement costs never take more than 5% of the estate. The only estate settlement costs incurred by any estate are

administrative costs. Further, these estate settlement costs may often be minimized by hiring an attorney on an hourly basis rather than paying the percentage fees often approved by the local probate courts.

This married person often pays no Ohio or federal estate tax even when the estate reaches \$3,000,000. This is true because the person is married at the time of death and leaves everything to their spouse. The unlimited Ohio and federal marital deductions mean that all property may pass to a surviving spouse tax free. This is frequently advisable for people of modest wealth who need not concern themselves with federal estate taxes.

However, it is almost never advised for persons who might be subject to federal estate taxes (joint net worth in excess of \$1,000,000) because it subjects the surviving spouse to the high tax rates shown in Table 5 above. For additional information see the discussion of the Marital Deduction and Balancing Estates above. These principles are illustrated in the section of the bulletin “Sample Estate Tax Calculations and An Illustration of Potential Savings From a Simple Estate Plan” and the alternative plans.

Table 6. Estimated Estate Settlement Costs for a Married Person Leaving Everything to a Surviving Spouse, Death Occurs in 2003, \$1,000,000 Applicable Exclusion Amount					
Net Estate¹	Administrative Costs²	Ohio Estate Tax³	Federal Estate Tax After State Tax Credit⁴	Total Costs	Percent of Estate Taken
\$50,000	\$2,500	\$0	\$0	\$2,500	5.0%
\$200,000	\$10,000	\$0	\$0	\$10,000	5.0%
\$500,000	\$25,000	\$0	\$0	\$25,000	5.0%
\$750,000	\$33,750	\$0	\$0	\$33,750	4.5%
\$1,000,000	\$40,000	\$0	\$0	\$40,000	4.0%
\$1,500,000	\$60,000	\$0	\$0	\$60,000	4.0%
\$2,000,000	\$70,000	\$0	\$0	\$70,000	3.5%
\$3,000,000	\$105,000	\$0	\$0	\$105,000	3.5%

¹ Gross estate (total assets) less debt and final expenses.
² Assumes executor took reduced or no fee.
³ Taxable estate for Ohio and federal estate tax calculations equals net estate minus administration costs.
⁴ Credit for Ohio estate taxes paid is reduced by 50% for deaths in 2003.

“Generation Skipping” Transfer Tax

Some people have established trusts that benefit generation after generation, and some of these trusts have never been subject to gift and estate taxes. Some grandparents have passed their estate into a trust (or life estate) for the benefit of their grandchildren but allowed the children to enjoy the income from the trust during the lifetime of the children. In so doing, assets in the “generation skipping” trust are not a part of the child’s taxable estate at their death. Because the government was losing so much revenue, Congress enacted a generation-skipping transfer tax at the highest estate tax rate, but provided an exemption of \$1,000,000, which is being indexed for inflation.

For federal estate tax purposes, you may transfer \$1,120,000 in 2003 (\$2,240,000 combined for a couple) free of the special “generation skipping” transfer tax. This amount will also be indexed for inflation, but will only increase in increments of \$10,000. In 2004-2010, the exemption will be equal to the applicable exclusion amount for federal estate tax purposes. Ohio assesses a generation skipping transfer tax on Ohio property that transfers at death. The Ohio generation skipping tax also has an exemption similar to the federal exemption. This exemption amount can be used to protect these assets from federal estate tax indefinitely, regardless of the value of the assets.

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