1-1-1972

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Probate another farm cost

By J. Ripley, Rural Economist

Death duties are too big a cost to be ignored on most farms, because most farms have substantial assets in land, stock, buildings and machinery. The saying "a wise man does not lay up treasures, the more he gives to others the more he keeps for his own" seems true of the types of estate planning outlined in the following article.
One sure thing about life is that it will be terminated by death. The unpleasantness of this prospect often tends to delay any thinking about or planning for the disposal of one's estate after death.

Another inevitable situation for anyone with net assets in excess of about $20,000 is that death duties will have to be paid on the value of the assets. Death duties are paid in the form of probate duty to the Western Australian Government and estate duty to the Commonwealth Government. The amount of duty payable depends on the beneficiaries and the size of the estate. Death duties become due for payment immediately after assessment, although under certain circumstances they can be paid over a period of time, with the consent of Taxation Commissioners.

At death, the deceased's assets are frozen and cannot be sold or borrowed against until death duties have been paid, unless agreed to by the Taxation Commissioners. Such concessions are only made under special circumstances.

In a farming situation where the assets are all in the name of the deceased, the estate is subject to the control of an executor. The executor may open an executor's account and pay into this all moneys received after death. The executor can draw against this account for normal outgoings. If there is no will or if an executor is not named in a will, the deceased's assets will have to be paid against until death duties have been paid. The executor can draw against this account for normal outgoings. If there is no will or if an executor is not named in a will, the deceased's assets will have to be paid.

Anyone who has assets must seriously consider formulating suitable plans covering the control of the assets after death. Many estates pay death duties well in excess of the amount they need have paid if the main asset holders had made adequate plans during their lifetime.

This article is mainly intended to deal with the aspect of death duties, but it is useful to also look at the likely income tax advantages which are the result of most forms of estate planning.

Examples
Various situations have been chosen to illustrate the costs of probate and taxation. It will be clear that the relative costs of these items and any plan formulated will depend on the individual case.

The examples shown in the table are based on assets assessed for probate at $70,000 and $140,000. To compare the costs of income tax with various situations, the examples use two taxable annual incomes of $10,000 and $20,000, with three cases—

1. Husband and wife—husband holds all assets in his name and income all in his account. Estate left to wife.
2. Husband and wife equal partners in asset holding, and share taxable income equally. Estate left to surviving partner.
3. Father, son and daughter-in-law—father has ⅔ share of asset, son has ⅔ share of asset, daughter-in-law has ⅓ share of the asset. Father leaves his share of the asset to son. Taxable income is split equally between the three partners.

These three situations are combined in Table 1 with the income tax costs calculated over a 10-year period for the two asset levels and the two income levels. No attempt has been made to allow for interest, or any other factors associated with calculations during the 10-year period.

The main point illustrated by this table is the result of the farmer (usually the husband) doing nothing about his estate. Under these circumstances, duty payable on his estate can be four to eight times greater than if, during his lifetime, he had arranged for half the total asset to be in his wife's name. In addition to this, the total income tax plus probate saving over a 10-year period can be considerable if relatively simple and inexpensive legal systems are used.

It must be emphasised that in Case 2, where the wife inherits her husband's half of the asset, steps must be taken by her to divest assets to avoid the possibility of duty being paid again on her husband's share when she dies. Other factors which will influence a strategy are the rate at which capital value of the asset will increase or decrease, and the likely future rate at which taxable income will rise or fall.

A farmer considering purchasing another property is likely to have a greater taxable income and a greater asset value. The way in which the farm is purchased is important, and in such cases it is usually purchased in the names of lesser asset holders. This strategy avoids building up the assets of major partners and spreads taxable income among as many as possible in the partnership.

The main methods of minimising probate and taxation costs are discussed below.

Family partnerships
Family partnerships are legally formed between husband, wife and others as necessary. These partnerships can involve all assets. Very often partnerships are formed including only stock and plant. In such cases the main object is the taxation benefit of dividing income among partners. In cases where probate is also a consideration the partnership may need to include land and this may be a more complicated and costly process, which requires the sale of the land to partners and a formal agreement detailing terms. The sale can be transacted over a period of years by gifting and profit allocation. The land sold can be portion of the total holding.

Family partnership formation is the most commonly used method of minimising taxation and probate costs. Formation of a partnership involves minimal costs and allows great flexibility concerning profit distribution, capital sharing, business control and dissolution.

Family companies
Family company formation is usually undertaken only where the asset holding is large, say, in excess of $150,000. It provides a means for the major shareholder to divest large amounts of capital while still maintaining control over the asset. Companies can often be used to minimise income tax as well but calculations are first necessary to ensure that the company taxation rates are smaller than those the individual would otherwise be paying. Companies do not pay provisional tax. They are often complex and require the continual services of an account-
The chief disadvantage to have taxation and probate costs. Those mentioned here are, however, the methods most commonly employed.

Trusts

The formation of trusts offers the opportunity for large-scale divestment of assets while allowing the senior partners to retain control over the asset. The chief disadvantage is that trusts are inflexible and terms are difficult to alter to meet changes in circumstances.

There are other methods of legally minimising death duty costs. Those mentioned here are, however, the methods most commonly employed.

Most people with assets are likely to have taxation and probate costs.

Wills

Any estate planning involves partners making wills which are such that they complement the strategy. Wills must be carefully thought out and as simple as possible. They should be changed if circumstances warrant.

Taxation may be an annual cost so most people try to reduce it, but many people are afraid of the thought of probate and do not give it the attention required. Many farmers’ wives and families have had to face excessive probate costs because husbands have been unwilling to discuss probate with their lawyers and accountants. Farmers who have not done so should obtain advice on how best to combine the lowest cost probate and taxation strategy. The family must then fit this to their desires and thus a final programme is worked out.

Control

Some farmers are reluctant to consider estate planning as they consider that by doing so they will lose control of their assets. This need not be so, as good estate planning will allow the senior partner full financial and management control over the assets, irrespective of how the assets are allocated between partners or shareholders.

Wills are made after the individual requirements of the family partners have been established and clearly explained. Many families of deceased estates are put in an untenable position when the estate is willed so that all family members have an equal share. In such cases the farmer is usually trying to be fair to all next-of-kin and also to leave the farm intact for a son, or even two sons to carry on farming. In many cases the estate is not large enough to cope with this situation and the son or sons cannot meet repayments to family members and still maintain viability. The testator must decide, preferably in conjunction with his family, whether he wishes the farm to continue as such and, if so, divide his assets accordingly.

It is essential for all family partners to make a will, as when no will is made standard principles of inheritance are enforced and these may not fit in with family wishes.

In conclusion, the cost of probate and taxation are a significant farm cost. These costs can be minimised and it is absolutely essential that each farming family be clear about the likely costs. Frank discussions with lawyers, accountants and other qualified advisers are essential to establish the strategy required to give the farmer the best possible probate and taxation benefits.

Examples of probate and tax costs for three family or partnership arrangements and two levels of asset and income

<table>
<thead>
<tr>
<th>Asset Value</th>
<th>Taxable Income</th>
<th>Cases</th>
<th>Probate and estate duty</th>
<th>Tax total over 10 years</th>
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