Farm Management

Understanding irrevocable trusts

Country Counsel

By ROBERT MOORE

AN irrevocable trust is a type of trust that is often used as a means of protecting assets from nursing home costs and creditors. While irrevocable trusts have several favorable attributes, they also have several negative characteristics that should be carefully considered. There are some situations where an irrevocable trust is very effective, but it is not a cure-all as is sometimes advertised.

The first step in analyzing an irrevocable trust is to understand the difference between a revocable and irrevocable trust. A revocable trust is the most common type of trust used for estate planning. This trust can be modified at any time after it is set up. It is quite common for revocable trusts to be amended many times as family situations change, farming operations change or any number of other changes occur that can cause an estate plan to change. The primary benefits of revocable trusts are to avoid probate and allow for complexity in an estate plan. Generally, revocable trusts allow for maximum flexibility in estate planning.

Tough to change

Irrevocable trusts, on the other hand, are difficult, if not impossible, to change. The concept is to set up a trust under certain rules, which keep the assets sheltered in the trust for the remainder of the grantor's life. The grantor gives up ownership of the assets going into the trust and relinquishes all control. At most, the grantor can receive income from the assets and reserve the right to live in the residence.

The idea is if the grantor cannot get to the assets, then neither can the nursing home, creditors or anyone else. The grantor can receive the benefit from the trust assets, but the nursing home cannot force the sale of the land to pay the grantor's bills. The farm will pass to the next generation.

For example, an irrevocable trust is set up to protect the farmland. A trustee is named. A deed is executed from the grantor to the trustee of the trust. The grantor reserves the right to receive income from the farmland and the right to live in the residence. A lease is executed between the grantor and the trustee. The grantor continues to farm the land and pays rent to the trust. The trustee deposits the rent into a checking account set up under the trust identification number. The trustee pays the real estate taxes and insurance, and then pays the net income to the grantor.

An irrevocable trust does protect assets. However, the grantor must give up ownership and control of the asset. This is the primary decision to make with an irrevocable trust. Is the additional protection provided for the assets worth giving up ownership and control?

Typically the trust terminates at the grantor's death, and the trust beneficiaries receive the assets. The grantor determines the beneficiaries upon setting up the trust, and the beneficiaries cannot be changed. This is another decision that must be made: Is the assets' additional protection worth giving up flexibility to change the beneficiaries in the future?

There are obvious pros and cons to irrevocable trusts. Before creating an irrevocable trust, carefully consider the limitations of the trust. Don't be scared or bullied into executing an irrevocable trust — educate yourself, weigh all your options and make an informed decision.

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Use ag software to track profitability

By **GAIL C. KECK**

Key Points

- As farmers analyze big data to improve yields, financial figures are still valuable.
- Comparisons to similar operations help farmers evaluate their financial health.
- Don't wait until the end of the year to collect the farm's records for taxes.

TECHNOLOGY may be bringing farmers better ways to collect and analyze data, but many are still neglecting the underlying financial data that indicates their farms' profitability.

"There's what's recommended and there's what really happens. There's a pretty big chasm between the two," says Barry Ward, production business management leader with Ohio State's Department of Agricultural, Environmental and Development Economics. It's common for farmers to keep only cash-based accounting records for taxes. Some also maintain a balance sheet for their lender, he notes. However, those records alone aren't enough to easily identify changes in profitability or pinpoint problem areas.

One problem is that cash-based records won't show changes in inventories, Ward explains. For instance, during years with high grain profits, farmers might defer sales to a later calendar year to minimize income tax for the year the grain was produced. Then, as profitability falls, they might reduce the amount they hold over. The same concept applies to a variety of products held in inventory. "We can hide a lot of things and sometimes hide them from ourselves," Ward warns.

To generate financial records and statements that show changes in a farm's financial health, Ward suggests farmers use recordkeeping designed for agriculture such as Farm Financial Planning and Analysis. FINPACK software lets farmers generate balance sheets, project cash flows, follow financial trends, create long-range plans and analyze profitability.

One thing FINPACK won't do is create budgets for different farm enterprises. Most farmers seem to do some sort of budgeting, even if it's in their heads or on the back of an envelope, Ward says. However, those who aren't budgeting need to start, he stresses. Considering the tighter margins expected for grain crops, it's important to have a handle on input costs.

Farmers tend to keep better financial records when they see a reversal in the market for their commodity or they are planning to transfer the farm, says Diane Shoemaker, OSU Extension field specialist, dairy production economics. Years ago when dairy margins were tighter, she saw a surge of interest from dairy producers. Now it is grain producers wanting a better handle on their financial standing.

When a farmer at year-end wants to analyze the farm's profitability, reconstructing the necessary records can be overwhelming, says Shoemaker. "If farmers have not been keeping good financial records, it's hard to do it." Instead, build records throughout the year, before trying to do any analysis. The best time to have started for 2015 would have been Jan. 1, but catching up now will be easier than at year-end. "Do it in real time," she advises.

Over time, records show a farm's overall financial position. And farmers can make better decisions about individual enterprises by tracking changes in input costs and returns. If they are using FINPACK, they can also compare their performance to other farmers in Ohio and the Midwest using FINBIN, a farm financial database managed by the Center for Farm Financial Management at the University of Minnesota. OSU Extension, along with other university Extensions and farm business management groups, submits data from farms using FINPACK, she says. All data is kept confidential, and all participants from different states use the same procedures to keep the data uniform. Reports from the FINBIN database can be generated online at *finbin.umn.edu.*

By comparing figures, farmers see how their overall financial performance compares. "The top 20% is always where you want to be," Shoemaker says. Farmers can also see if their costs for various inputs are in line with what other producers are spending, she adds. "If there are red flags, let's do something about it."