Account Receivable Financing/Leveraging

Introduction

- The concept of Accounts Receivable Financing has evolved from traditional factoring (selling A/R at a discount for immediate cash) to using the A/R to collateralize a Line of Credit
- This tries to meet two primary objectives:
  - Shielding the A/R from creditors and lawsuits, and
  - Converting an otherwise stagnant asset into one that yields a return*.

*This might be a good financial tool but it also might work out as a terrible investment.

Physicians

- This topic is mainly pitched to physicians who are feared into purchasing an A/R financing plan.
- The pitch is that the only major asset of a medical practice is the A/R and it should be protected from creditors by taking out a loan against it.
- The sale’s pitch is that the concept will also help a physician retire early because the borrowed funds are placed in a cash building life policy where the money can grow tax free and come out tax free.

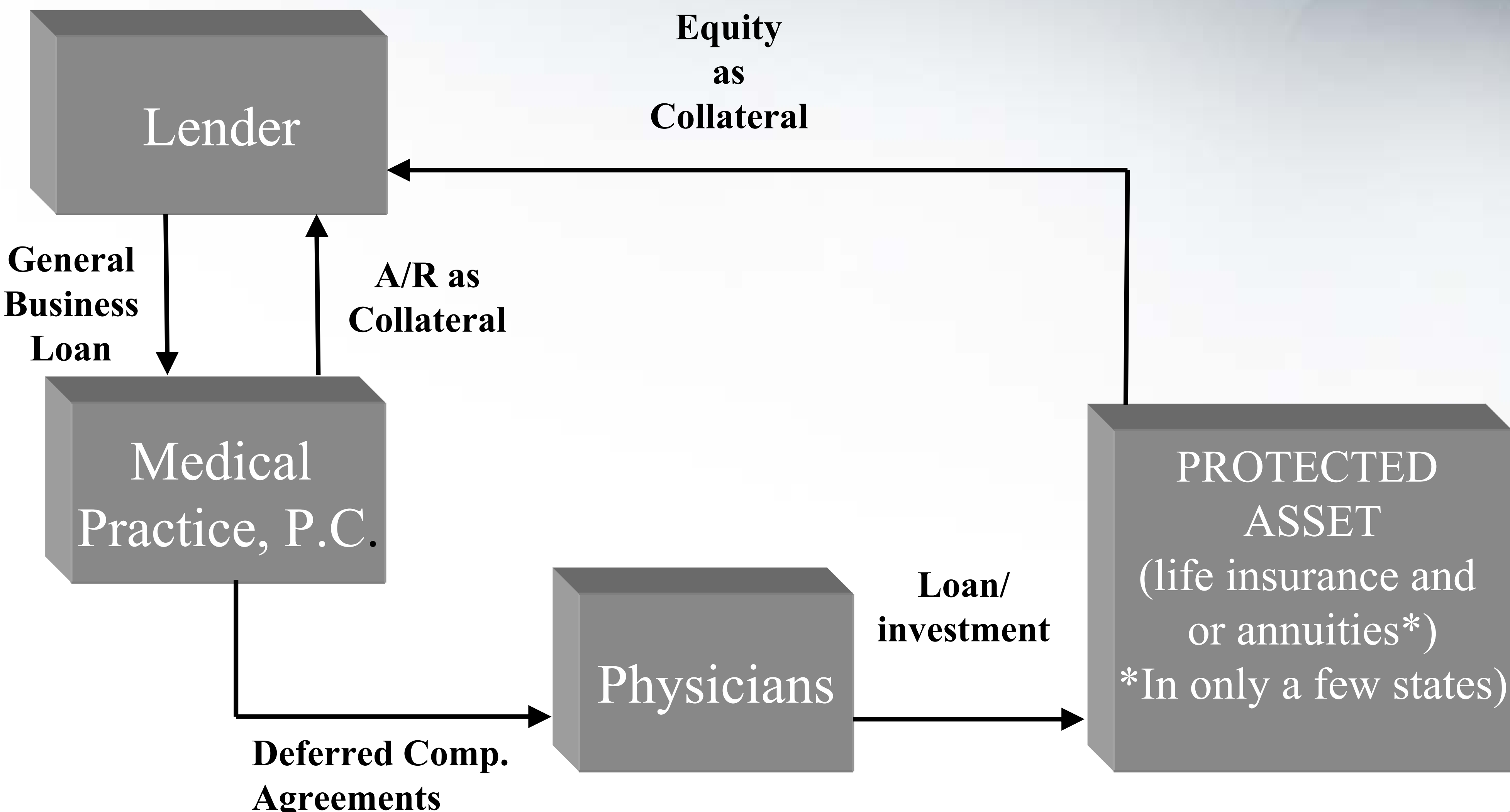
Abuses

- There are MANY problems with the way this concept is sold.
- Clients are told they can write off the interest on the borrowed money. They can’t.
- They are told there will be enough A/R at the end of the loan period to pay back the loan. There won’t be.
- Be careful with this topic, it will sound terrific when in fact it is a marginal topic from a financial standpoint.
- If you want to build wealth using borrowed money (which is a good idea), use the equity in your home where we know you can write off some or all of the interest from the loan (and using the 1% CFA mortgage also enhances the benefits).

To be brief

- The A/R financing topic can be a bit complicated.
- What we want to tell you first is what you should not be doing.
- What’s that?
- You should NOT have the company borrow the money and then slide it to the employee owner as non-taxable deferred compensation.
- You should NOT be writing off the interest on the loan.
- You should not allow the money borrowed to be invested into Variable life insurance.

The INCORRECT way to implement A/R Financing



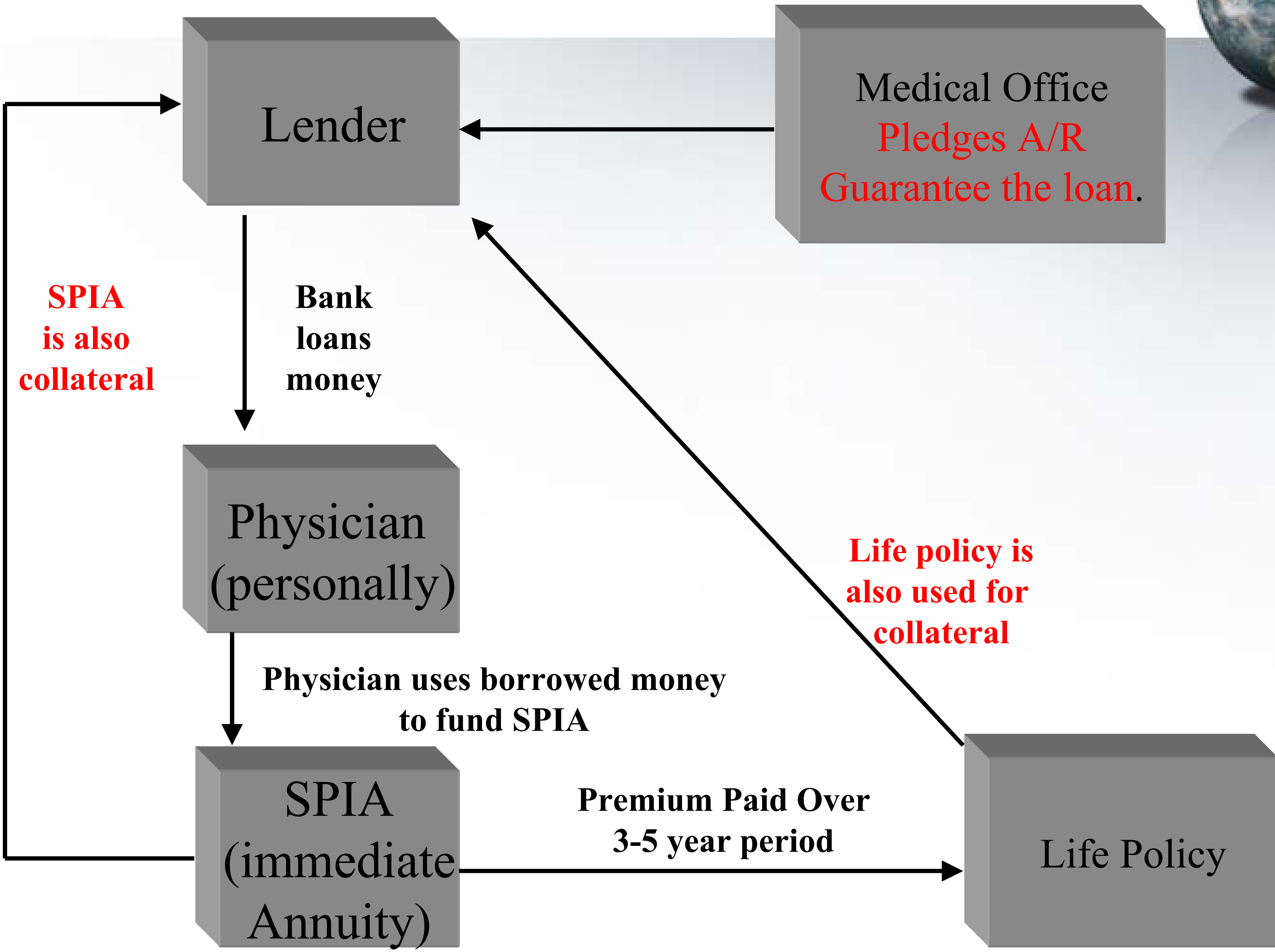
A/R Financing the Right Way
The "Personal Loan Approach"

- In this approach there is no attempt to create an arbitrage situation through deducting interest on the loan and receiving tax-deferred growth on the loan proceeds.
- A personal loan to the physician is used, and personal loan interest is not deductible.
- This **conservative** approach takes no deductions and avoids no taxes.
- The mechanics are simple and easily understood with no "gray" areas.

Mechanics

- A physician applies for a personal loan in an amount equal to his/her collectible A/R.
- This will be an interest only loan (**<u>which is NOT deductible</u>**).
- Two forms of collateral are given to the bank.
- The primary collateral for the loan is a **<u>Guaranty by the physician's practice</u>** using the collectible A/R as collateral for the Guaranty.
- The bank accepts this practice Guaranty, files a UCC1, and the A/R are shielded.

A/R Financing: The Right Way



Continued

- When the physician retires there will not be enough A/R to repay the loan. This is the case in all A/R financing plans.
- The correct sales pitch is to disclose this problem and explain to the client that the reason the A/R on the books will not pay back the loan is due to the fact that income taxes are due on the A/R (which will leave a shortfall).
- The physician can pay for the shortfall out of his/her own pockets or take cash out of the life policy that was initially purchased.

Summary

- The A/R financing plan has been around for 20 years and has never been a more popular plan among life insurance agents.
- Agents continue to pitch the plan as a deferred compensation plan instead of how it should be pitched which is as an asset protection plan.
- It is important to understand the pros and cons of the various ways to implement the A/R financing plan so when and if your clients are solicited by others.
- To the extent you are interested in asset protection, you'll be armed with all the needed knowledge to help implement a plan the correct way through the personal loan approach.
- For help with this topic, please feel free to contact our office.