Accounts Receivable Business Continuation Plan: The "ABC Plan"

Introduction

If you are a small business owner making significant taxable income, you are probably tired of hearing about all the too-good-to-be-true income tax reduction plans that never pan out after a thorough review of the plan is completed.

If you are ready for an "advanced" plan that is so simple you wonder why it has never been done before, then you are ready to review the ABC Plan. The ABC Plan is the simplest "advanced" plan in the marketplace that every CPA or attorney in the country will not only understand with relative ease but should also approve without having a salesperson give the hard sell.

The ABC Plan is a program created for small business owners who are interested in business continuation and income tax reduction.

With the ABC Plan, small business owners can make their A/R more difficult for creditors to collect, reduce the owner's current take-home income, and assure that the business at a predetermined period of time in the future will have cash flow.

How?

Through an installment sale of the business's accounts receivables (A/R).

How does the ABC Plan work?

1) A business sells a specific amount of A/R to a Factoring Company ($25,000-$100,000+).

2) The Factoring Company (hereinafter FC) takes a 5% factoring fee on the A/R factored and issues to the business an installment note for payment of the remaining 95%. This installment note has repayment terms as dictated by the business selling the A/R.

3) When the business collects the A/R that was sold, that money is transferred to the FC.

4) The FC invests the money it receives (minus the 5% factoring fee). Typically, the money is invested in indexed annuities that have minimum guarantees and growth pegged to the S&P 500 index.

5) When the installment note comes due to pay the business, the FC pays back to the business the initial amount factored (minus the original factoring fee) plus any growth on the money (as it was pegged to the S&P 500 index).

6) The business then can choose to use the money for any business purpose, including the option of paying it to the owners or employees as a bonus.

Example

Assumptions: Assume the client, Dr. Smith, age 40, works for XYZ Orthopedic Clinic, P.C., makes $600,000 a year and has an extra $100,000 he does not need to take home as income this year. Further, assume the medical practice at any given time has $700,000 of real A/R on the books and Dr. Smith's patients represent $200,000 of that A/R.

Implementation:

1) XYZ Orthopedic Clinic contracts with FC to sell $100,000 of A/R in exchange for an installment note that will be payable starting in 21 years and will pay in a lump sum when Dr. Smith is 60 years old.

2) The FC takes a 5% factoring fee and invests $95,000 (typically the money is invested in indexed annuities with a minimum guarantee and growth pegged to the S&P 500 index).

3) If that $95,000 grew at 7% for 21 years, there would be $310,835 at the end of the 21-year period. That $310,835 would come back to the medical practice via the installment note in lump sum at the end of the 21st year (when Dr. Smith is age 61).

4) The medical practice can use the money for any business purpose and can choose to disperse it out to Dr. Smith as income. If Dr. Smith received the $310,835 in a lump-sum bonus from the medical practice, he would have **$186,501** left after paying tax on the money in the 40% tax bracket.

5) In the above example, if Dr. Smith invested $60,000 post-tax in the stock market for the same 21-year period, he would have **$130,686** in a post-tax brokerage account. Therefore, the ABC Plan worked **45% better than post-tax investing**.

Continuous contracting

If the medical practice so desires, it can choose to sell a similar or different amount of A/R each year. Using the Dr. Smith example, XYZ Orthopedic could factor $100,000 a year for 10 years. If the money at the factoring company grew at 7%, there would be $2,481,844 that could be paid in a lump sum to the medical practice at the end of 21 years.

If the medical practice did not desire to have an installment note paid in a lump sum, it could direct via the installment note to have that money paid to the medical practice over any period of time up to 30 years.

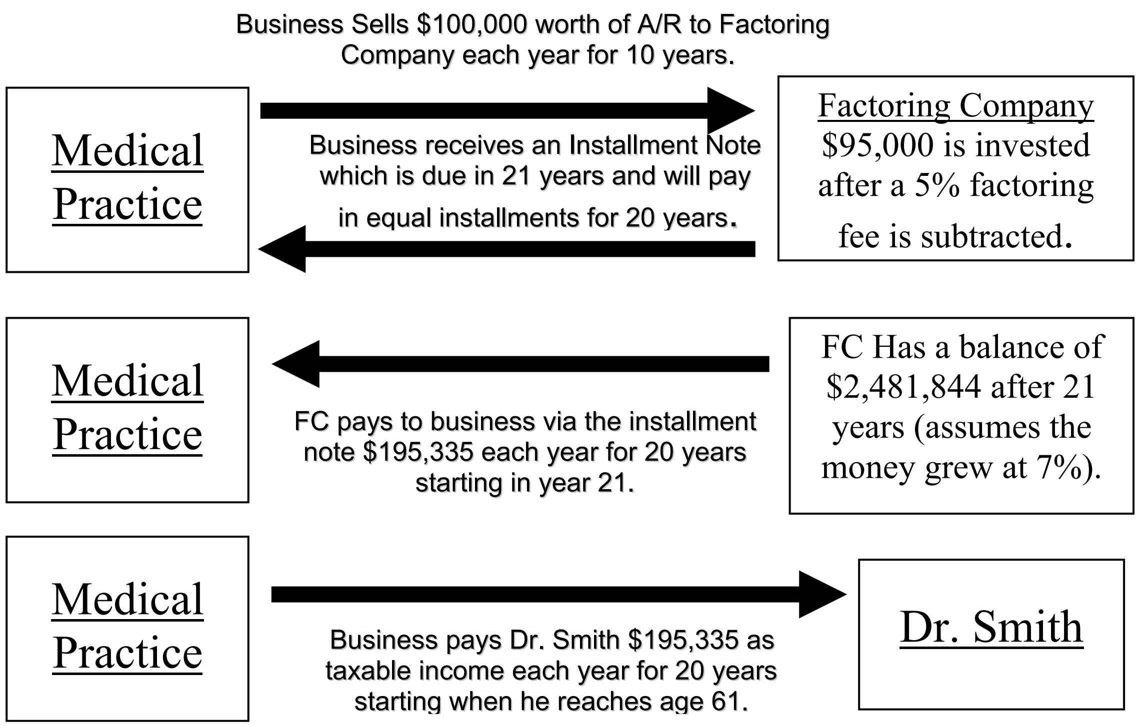
The ABC Plan vs. Post-Tax Investing

In the 10-year continuous contracting example, Dr. Smith could take home $195,335 a year for 20 years as taxable income (leaving $117,201 a year after tax in the 40% bracket).

If Dr. Smith instead of implementing the ABC Plan took his $60,000 home after tax ($100,000 x 40% tax) and invested it in the market at 7% (where typical income and dividend taxes are levied ever year), Dr. Smith could take out of his brokerage account $77,318 a year after tax for that same 20-year period. The ABC Plan returned to Dr. Smith **52% more income each year from ages 61-80**.

The ABC Plan is a terrific and simple income deferral/wealth building tool that will be a nice fit for many clients and is a topic advisors will not have to spend hours explaining to the client.

The following is a schematic illustrating the 10-year funding example.



Pros and cons of the ABC Plan

Pros –

A) Simplicity – The ABC Plan is about the simplest "advanced" plan in the marketplace. All a business has to do is identify A/R it would like to factor, sell the A/R via an installment note and, at a set time in the future, have the amount factored and the growth on that money returned to the business.

B) Principal Guarantee –The Factoring Company typically uses as its investment vehicle products that have guaranteed minimum rates of return to assure that the Factoring Company will always have the money needed to pay the installment that eventually becomes due.

C) Variability – Many of the asset protection/income tax reduction topics in the marketplace use life insurance as an investment (which is a good wealth accumulation tool when used tax favorably). The main problem with life insurance is that a client 1) needs to commit to a period of level funding and 2) cannot access the cash via policy loans until the surrender charges evaporate in the life policies (which typically takes 10-15 years).

With the ABC Plan, the business chooses to implement the plan annually for whatever amount it sees fit. One year the business could factor $100,000, and the next year it could factor $0 or $250,000. Because each year is a new installment note payable by its own terms, there is no requirement to fund every year.

D) Tax Simple – While most CPAs and attorneys are not used to reviewing the "creative" income tax reduction plans in the marketplace, all CPAs and attorneys are familiar with installment notes and factoring. The ABC Plan is one that should not be difficult for a client's advisor to review and approve as a conservative asset protection/income tax reduction/business continuation plan.

Cons –

A) Lack of investment control – The factoring company has the ultimate authority to invest the money as it sees fit. The business selling the A/R cannot control the investment or direct where the money will be invested. The FC typically uses principal guaranteed products so the FC will have the money to pay back the installment note (and the FC typically uses indexed annuities pegged to the S&P 500 which should generate rates of return between 7-10% long term).

B) Lack of flexibility when repaying the installment note – Except for certain circumstances, the time table for repayment of the note will be set the day the installment note is issued. So, if the business selling their A/R accepts a note where payment will not happen for 15 years and the business needs money, it will not be able to go to the Factoring Company and demand early payment.

Early payment options

The following circumstances allow Seller to receive early payment on the note:

1) Death of an identified key executive.

2) At the discretion of Seller: anytime after the note has been in place for 12 months with 90 days written notice to the FC. With this option, the Seller is assessed a 6% penalty on the balance to be paid back to Seller.

Vitals about the plan

-The factoring company is a $100,000,000+ net worth company that guarantees repayment of the note.

-The Installment obligations are protected from creditors of the factoring company due to the fact that they are owned by Special Purpose Delaware Trusts.

-There has been more than $300,000,000 factored into the plan from 2002-2005.

-The plan has been approved for use by over 50 CPA/accounting firms.

Conclusion

If you are looking to reduce your income taxes, the ABC Plan is the simplest “advanced” income tax deferral plan/business continuation plan in the marketplace. The ABC Plan while creative is not going to raise the eyebrows of your local CPA and, most importantly, that of the IRS.

We strongly recommend the ABC Plan as a main instrument in your financial plan which should ultimately lead you to “Total Financial Independence” and, in turn, a worry-free retirement.

If you would like more information on the ABC Plan, please feel free to contact our office.