The "Truth" About Account Receivable Financing

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The Wealth Preservation Institute

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Introduction

- The concept of Accounts Receivable Financing has evolved from traditional factoring (selling A/R at a discount for immediate cash) and using the A/R to collateralize a Line of Credit, to more sophisticated approaches seeking 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.

Continued

- All A/R Financing Plans use a loan from a bank. The loan is collateralized by the A/R, **and once the bank files a UCC1 this lien takes priority over any other creditor**. It is paramount that the A/R be truly at risk and truly serving as **primary collateral** for the loan.
- Most A/R Financing plans pour the borrowed money into a single premium immediate annuity which will pay into the life insurance policy over a 3-7 year period.
- The SPIA is used to guarantee the premium payment will be made and to keep the policy from becoming a “MEC.”

Who can benefit from A/R Leveraging?

- The primary users of A/R Financing plans are <u>physicians</u>.
- As we all know, physicians are particularly vulnerable to lawsuits.
- When a physician gets sued, the medical practice always get sued as well (the shotgun approach by personal injury attorneys).
- Technically any asset of any company is at risk in a negligence suit and this would include a medical practices’ A/R.

The FEAR sale, The Greed Sale

- Doctor: did you ever think about the fact that your A/R is the largest asset of your medical practice and that it is an asset which is subject to the claims of creditors?
- Also, isn't the A/R your largest stagnant asset (meaning it is an asset that is not building wealth).
- No I never thought about that before.
- Doctor: would you like me to show you how to protect your A/R from creditors and show you how to create significant wealth for your retirement at the same time?
- Absolutely.

Total Garbage

- This sales approach is total garbage in my very informed opinion.
- Understand that I used to sue doctors for a living when I practiced law, I ran a medical practice for three years and I'm licensed to sell malpractice insurance to doctors (not to mention that I wrote a book called The Doctor's Wealth Preservation Guide where I show doctors how to do real world asset protection).

Disingenuous Sale

- The A/R financing sale is the most disingenuous sale in the insurance industry (and that's saying something).
- Why?

A/R not really at risk

- The A/R is <u>hardly at risk</u> in a medical malpractice suit. Ask around, have you ever heard of anyone actually losing their A/R in a med malpractice suit?
- The answer will be no.
- Think of this.
- A doctor has med. malpractice coverage AND the practice has its own separate coverage with a separate policy and limits.
- The company policy is usually 10-20% of the doctor’s cost for his/her policy.
- Why?
- Is it because insurance companies want to lose money?
- No, it’s because the practice has very little liability in your typical med. mal. case.

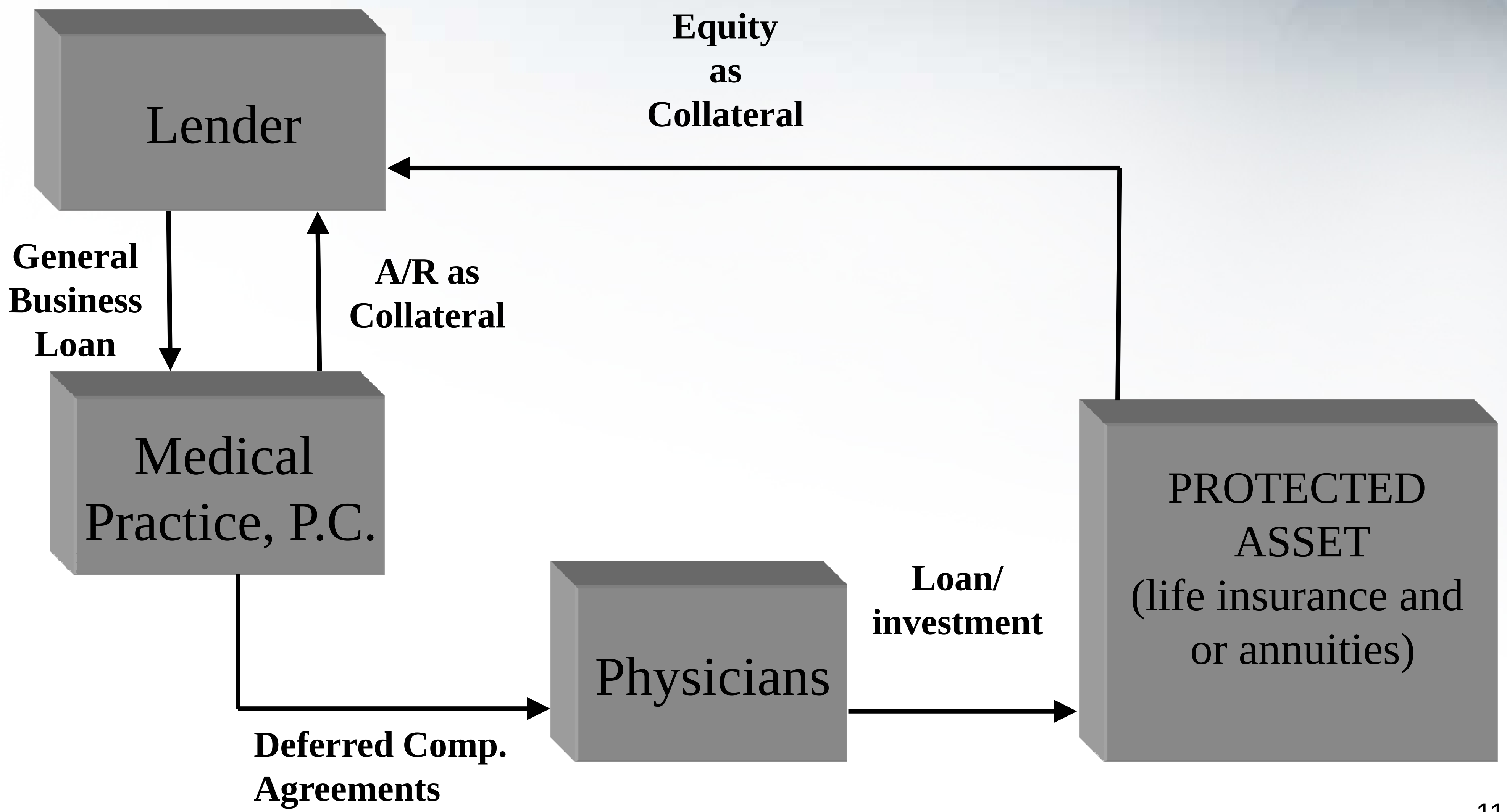
Write off the interest

- This is a comedy when you hear the “sales” pitch.
- The doctor many times is told to write off the interest.
- This is footnoted in most sales presentations.
- It’s footnoted because the vendors who have this concept will not officially tell a client the interest can be written off.
- Typically this issue is left to the local CPA who has no idea that you really shouldn’t write it off.
- If you can’t write off the interest with this concept, few will do it because the numbers on paper might work out, but since we don’t live on paper and have to deal with the variables of the topic, it’s too risky financially for many to get invovled with.

The A/R at retirement will pay off the loan?

- While for 30 seconds this makes sense, it should not be explained to a client this way.
- When the physician retires there will **<u>not</u>** 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 pocket or take cash out of the life policy that was initially purchased.

1st generation financing plans



Problems with the 1st generation

- 1) The client medical practice was told to write off the interest on the loan.
  - If a client could write off the interest and fund a life policy where tax free loans can be taken in retirement, the plan becomes a terrific investment.
  - Section 264(a)(2) of the Internal Revenue Code provides that amounts paid on indebtedness incurred or continued, directly or indirectly, to purchase or to continue in effect a single premium life insurance or single premium annuity contract are **not deductible under section 163 or any other provision of the Internal Revenue Code**.
  - In the A/R leveraging plan, the borrowed money is paid in lump sum to an annuity which in turn funds a life policy.

Systematic Borrowing

- Section 264(a)(3) of the Internal Revenue Code provides that that amounts paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance, endowment, or annuity contract (other than a single premium contract or a contract treated as a single premium contract) pursuant to a plan of purchase which **contemplates** the systematic direct or indirect borrowing of part or all of the increases in the cash value of such contract are **not deductible** under section 163 or any other provision of the Internal Revenue Code.
- **When advisors finally realized that the interest on the loan should not be written off, many stopped selling the plan**.

Other problems

- There were other problems to the old school A/R Leveraging plan.
  - Timing of Inclusion of Income
  - Substantial Risk of Forfeiture
  - Prohibited ERISA Transaction
  - Using variable life policies

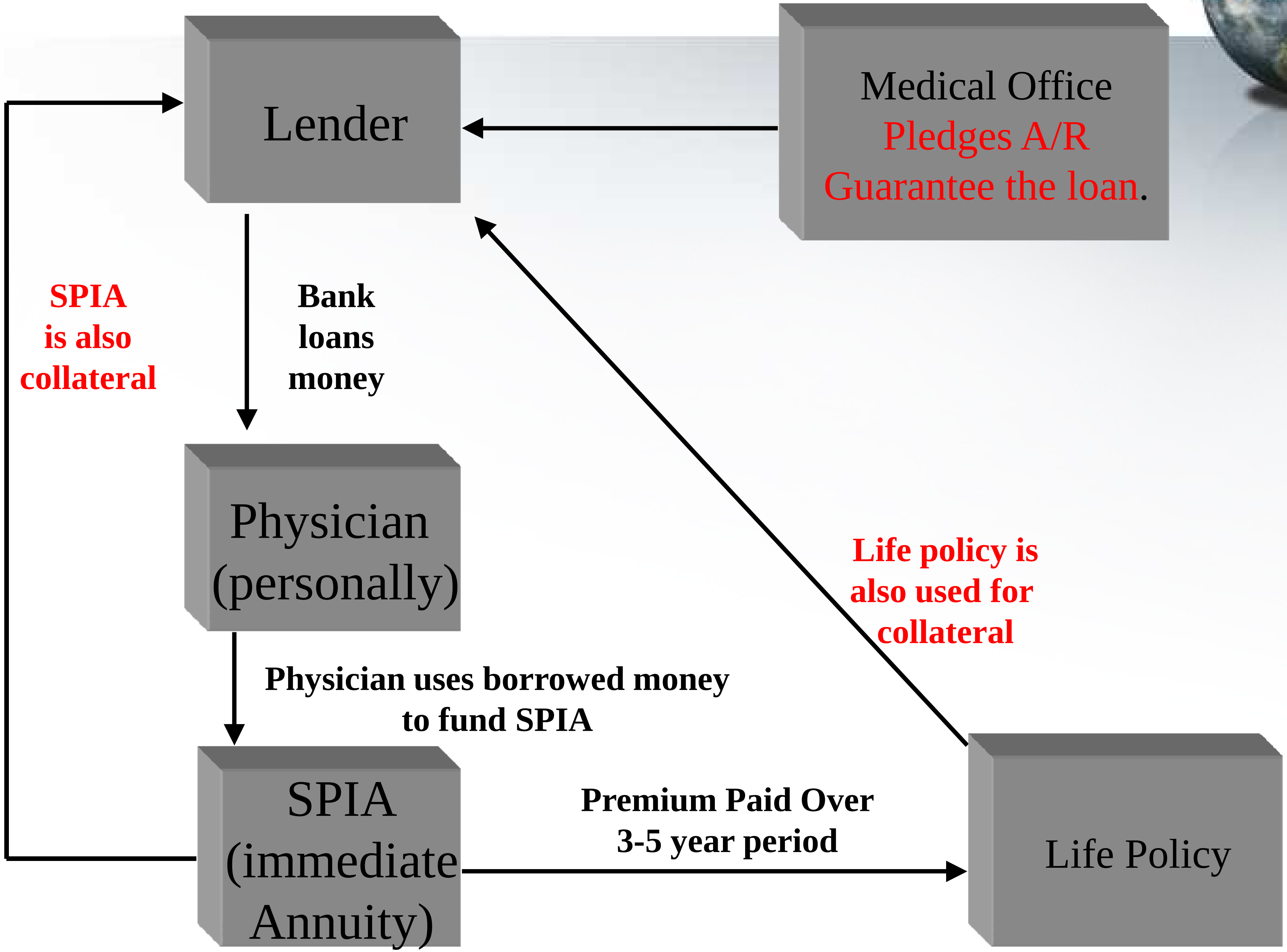
A/R Financing the Right Way
The “Personal Loan Approach”

- 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 (**which is NOT deductible**).
- Two forms of collateral are given to the bank.
- The primary collateral for the loan is a **Guaranty by the physician’s practice** 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



Can this work financially?

- Yes.
- IF interest rates stay low
- IF the client's life insurance policy has good returns.
- Problems?
  - The loan is typically locked for 1-5 year (remember in the 1980s when rates were 18%+).
  - What if the policy does not return as illustrated? They never do that do they?

Continued

- Some firms are using “**high cash value**” LI policies.
- Most of these are used so the client can have at the end of year 5 the same amount of CSV as they borrowed.
- Why?
- So if the client wants to get out of the program they can.
- Why is this important?
- It’s a hedge so the agent doesn’t get sued when a client realizes that the policy under performed and/or interest rates went through the roof.
- Remember that these plans are sold and illustrated where a loan stays in place for sometimes 20+ years.
- That requires a lot of hedging.

Other considerations

- Some clients will lower their malpractice insurance policy limits after the A/R financing plan is implemented.
- Many clients are told to get rid of their current life insurance policies.
- Don't do it.
- Never ever ever tell a client to get rid of their malpractice insurance.
- At least have them purchase litigation expense coverage.
- Costs to litigate a frivolous malpractice case are over $75,000 and can go over $200,000.

Bottom line?

- The bottom line is that if a client is sold this plan with FULL DISCLOSURE and still wants to do it, I really do not have a problem with it.
- I would **<u>NEVER</u>** pitch this plan as an asset protection plan and instead I would pitch it on the finances of borrowing money in a non-deductible manner which might or might not work out financially.
- IF the policy performs well and IF interest rates stay low, it will work, if not it won’t.
- If your clients want to take that risk, more power to them.

Alternative Planning

- <u>“Advanced” Planning</u>
- If you have clients who have $200,000 or more they would like to deduct from their company to build wealth, they should consider a Captive Insurance Company.
- It’s a much more tax favorable way to build wealth.
- The premium is 100% deductible to the business and not taxable to the CIC.
- Cash value life insurance can be used as a wealth building tool in the CIC so the money can grow tax free.
- Upon closing the CIC down in retirement, the client pays capital gains taxes on the money instead of ordinary income taxes.
- A CIC can also be structured so the money can be removed completely tax-free with the preferred LLC structure.

What’s my point

- My point is that you do not have to FEAR clients into using the A/R financing plan.
- The insurance industry is getting behind the A/R financing topic because it is desperate to sell life insurance.
- If you use this plan, do it correctly with full disclosure.
- My position is: why use it when there are other topics that are so much better?
- *FYI, This powerpoint in no way deals with or tries to explain the PRS plan.

Questions?

www.thewpi.org

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Overview for the Professional Designation: CWPP™ (Certified Wealth Preservation Planner)

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What do Advisors want?

- To earn more money?
- To have more knowledge than other advisors?
- To provide better advice to clients on multiple topics?
- To be more credible than other advisors?
- A team of advisors for support and back office when dealing with “advanced” planning.
- The ability to market to CPAs, Attorneys and physicians through continuing education credit.
- Are these of interest to you?
  - If so you are a candidate to become a CAPP™ or CWPP™

The WPI and CWPP™/CAPP™

- What is the Wealth Preservation Institute (WPI)?
  - The **only** educational entity in the country devoted to providing education on **"advanced" planning (**asset protection, tax and estate planning)
  - The **only** entity in the country focusing on topics that apply mainly to the **high income/net worth client**.
  - Certifying entity for the CWPP™ designation.
- The CWPP™ course is a 24 hour certification program which can be taken all online or in-person.
- The Certified Asset Protection Planner designation is for those simply want to deal with AP (18 hours).

Are you should learn "Asset Protection"

- Why learn asset protection?
  - 99% of your current and future clients are not asset protected.
  - Most clients with wealth, once made aware of this fact, will want help.
  - Once you learn the topic you can help.
  - You are **not** talking "product" with a client and therefore will not be seen as pitching product.
  - Of all the topics you would deal with, asset protection is the best **client gathering tool**.

Topics

- What topics are covered in the CWPP™ course?
- **Asset protection (3 hours)**

  -Domestic

  -Offshore
- **Deferred Compensation (4 hours)**

  -Traditional NQDC and the Leveraged Bonus Plan®

  -Qualified plans/412(i) plans ("carve-out" planning)

  -ESOPs

  -IRAs
- **Business Planning (6 hours)**

  -Account Receivables (A/R) Leveraging (done the right way)

  -Section 79 Plans

  -Closely Held Insurance Companies

  -Corporate Structure

  -International Tax Planning

Continued

- **Estate Planning (8 hours)**
  -Basic
  -“Advanced”
  - Life Insurance
  -Qualified Pension Insurance Partnership®
  (Mitigating the 75% Tax Trap)
  -Charitable planning
  -Long Term Care Insurance
- **Personal Finance (4 hours)**
  -Annuities
  -Life Settlements
  -1% CFA Mortgages (Equity Harvesting the “right” way)
  -Reverse Mortgages
  -The Maximizer
  -Premium Financed Life Insurance

Marketing

- The WPI helps its certified advisors market in several very unique ways.
- 1) The ability to become an instant author through a 340+ page "**ghost book**."
- The WPI will allow CWPP™ advisors to give CPE continuing education courses on a local level to CPAs and accountants.
- Ability to give CME seminars to physicians.

Continued

- The WPI has a number of **articles** that CWPP™ advisors can use to place in local medical, accounting, legal, and other business journals.
- The WPI also has dozens of PowerPoint presentations CWPP™ or CAPP™ advisors can use to present topics to either clients or other advisors. (what a time saver).

Marketing continued

- **<u>Ghost Web-Site</u>** for those who want a web-site which tells your clients about your special knowledge.
- www.thewpi.org/template
- **<u>E-newsletters</u>** the WPI creates for you to send out to your clients.
- **<u>E-newsletter blasting system</u>** so you can drip on your clients with Educational newsletters.
  - This system is setup to track who opens your newsletters and how many times they open them.
  - Can you imagine calling a client and telling them that you noticed they opened the last e-newsletter 5 times and you wondered if you could answer any questions for them.

Should you become a CWPP™?

- YES. IF you are looking to learn several new topics which:
  - can help high income/net worth clients;
  - can help position you as the client's trusted advisor and team leader;
  - are very insurance and annuity friendly.
- If you are looking to become better educated on topics you currently deal with.
- If you would like keep updated on law changes, new concepts and have access to PowerPoint presentations, articles and the ability to have your own "Ghost" book and ghost web-site and e-mail blasting system.

How to sign up.

- If you would like to sign up to become a CWPP™ and/or CAPP™ advisor, you can do so by clicking on the appropriate tabs on the left front bottom part of the web-site under Product Categories
- You can take the course entirely online or in person.
- You can **get started with a $500 deposit** which will get you access to over 640 pages of CWPP™ course material and the tests.

Questions

Please contact The WPI at

269-216-9978 or e-mail at

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